S. HRG. 98-220

SINGLE-EMPLOYER PENSION PLAN TERMINATION INSURANCE IMPROVEMENTS ACT OF 1983

HEARING

BEFORE THE

SUBCOMMITTEE ON LABOR

OF THE

COMMITTEE ON LABOR AND HUMAN RESOURCES UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

S. 1227

TO AMEND THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974 FOR THE PURPOSE OF IMPROVING THE SINGLE-EMPLOYER PENSION PLAN TERMINATION INSURANCE PROGRAM ESTABLISHED UNDER TITLE IV THEREIN

JUNE 14, 1983

Printed for the use of the Committee on Labor and Human Resources

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SINGLE-EMPLOYER PENSION PLAN TERMINATION INSURANCE IMPROVEMENTS ACT OF 1983

TUESDAY, JUNE 14, 1983

U.S. SENATE,
SUBCOMMITTEE ON LABOR,
COMMITTEE ON LABOR AND HUMAN RESOURCES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 8:55 a.m., in room SD-430, Dirksen Senate Office Building, Senator Don Nickles (chairman of the subcommittee) presiding.

Present: Senator Nickles.

OPENING STATEMENT OF SENATOR NICKLES

Senator NICKLES. Good morning. Today's hearing concerns provisions of Senate bill 1227, a proposal designed to aid the financially troubled single-employer termination insurance program set out in title IV of ERISA.

Currently, the Pension Benefit Guaranty Corporation is some $333 million plus in the red, although there is still a positive cash flow. Since our last hearing in May 1982, several important events have occurred that need to be reviewed only briefly.

The PBGC settled its lawsuit with Facet on terms fair to both parties. Additional large terminations were dealt with on similar terms. Finally, Braniff Airways terminated its underfunded plans, which has added substantially to the financial burden placed on the PBGC.

Last year the $6 premium was viewed by many people to be too steep. Clearly, the facts supporting the $6 request have been changed due to the passage of time. The Government Accounting Office has submitted a four-page letter in support of the $6 premium and in support of other changes embodied in Senate bill 1227. I will put the GAO letter in the record.

[The following was received for the record:]

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-211961

JUN 13 1983

The Honorable Don Nickles
Chairman, Subcommittee on Labor
Committee on Labor and Human Resources
United States Senate

Dear Mr. Chairman:

We appreciate the opportunity to comment on S. 1227, a bill to amend the Employee Retirement Income Security Act of 1974 (ERISA) for the purpose of improving the single-employer pension plan termination insurance program. The program, administered by the Pension Benefit Guaranty Corporation (PBGC), insures that participants in such plans receive certain benefits when sponsoring employers terminate underfunded plans. The bill would provide PBGC with a premium rate increase and would

--authorize PBGC to place conditions on funding waivers sponsors are granted by the Internal Revenue Service (IRS) to improve insurance program recovery prospects should plans terminate,

--prohibit ongoing sponsors from terminating insufficient plans unless the sponsor shows PBGC that it could be forced out of business if it continued plan contributions and PBGC obtains assurance that it will collect the insufficiency from the sponsor, and

--establish a contingent liability for certain sponsors divesting portions of their business with underfunded pension plans that later terminate.

The bill also provides that PBGC submit reports to the Congress within 2 years that identify (1) alternatives for performing some or all of PBGC's functions through private insurers and (2) alternative premium rates and bases that are derived in whole or in part from risks insured by PBGC.

We have been studying PBGC's assumption of pension plan liabilities under ERISA and believe measures such as those proposed in S. 1227 should be implemented to improve the financial stability of the insurance program. PBGC has operated for 5 years without an increase in premiums at a time when reported program deficits have increased from $95 million in fiscal year 1977 to $333 million in fiscal year 1982.

Based on our assessment we believe that the $6 premium rate is both reasonable and necessary. We also support the other legislative changes proposed in the bill and offer the following suggestions for your consideration.

SECTION 7 - FUNDING WAIVERS

Under current law IRS can waive the employer's payment of minimum plan contributions during periods of business hardship. PBGC's insurance program can benefit if the waiver allows the sponsor to survive and its plan to eventually become sufficient. On the other hand, insurance program claims can increase if plans which received the waivers terminate before payment to the plan is completed.

PBGC currently has no statutory role in such transactions. Section 7 of the bill would amend ERISA by authorizing PBGC to impose terms and conditions on the waivers granted by IRS. The bill also provides that, as a matter of law, a lien in favor of the plan for the waived amount automatically arises on all of the employer's real or personal property at the time a funding waiver is granted. In case of bankruptcy or insolvency proceedings, the lien is to be treated in the same manner as tax due and owing the United States.

We believe the proposal to give PBGC a role in imposing terms and conditions for the waiver of contributions represents a positive step in improving PBGC's involvement in the minimum funding waiver process.

SECTION 8 - TERMINATION OF INSUFFICIENT PLANS

When pension plans terminate, sponsors are obligated by ERISA to finance any deficiency in plan assets needed to meet guarantee levels of the insurance program up to a limit equal to 30 percent of the sponsor's net worth. Although the Congress anticipated that such liability provisions would deter solvent sponsors from terminating underfunded plans and produce a reasonable, although limited, recovery of liability from insolvent sponsors, it is not clear that these objectives have been effectively met.

Revisions proposed in S. 1227 would make termination of insufficient plans proposed by plan sponsors effective only where PBGC finds that a sponsor has proven that it would be forced out of business if it continued contributing to the plan. Where the sponsor is continuing in business PBGC must, as a condition of termination, find that it

--will receive the lesser of 30 percent of the employer's net worth or the plan asset insufficiency;

--will receive all outstanding contributions owed the plan, including amounts waived by IRS; and

--is reasonably assured it will receive any amounts necessary to fund the plan's unfunded guaranteed benefits remaining after the above collections from future employer profits, considering the best interests of the employees, employers and PBGC.

These proposed changes will afford PBGC with a means for collecting plan asset insufficiencies from sponsors terminating pension plans and continuing in business. However S. 1227 leaves intact the 30 percent of net worth limitation for collection of employer liability from sponsors discontinuing business, thus precluding in most cases recovery of any significant portion of the plan asset insufficiencies from these sponsors.

The Committee may wish to amend ERISA to eliminate the 30 percent net worth limitation and provide for PBGC to claim all of the plan insufficiency from the sponsor. This would enable PBGC to recover a greater portion of the plan asset insufficiency where sponsors discontinuing business retained unsecured assets at plan termination. It would also make single-employer liability provisions of ERISA compatible with ERISA multiemployer provisions which were revised in 1980 to make employers participating in such plans fully liable for their allocated portion of the plan asset insufficiency without limitation of net worth. Earlier legislative proposals (S. 1541, H.R. 4330, and H.R. 4334 introduced in July 1981) included provisions giving PBGC the authority to claim the full amount of plan asset insufficiency as a general unsecured creditor at plan termination.

SECTION 9 - CONTINGENT LIABILITY

Responsibility for unfunded pension liabilities can be transferred to a new sponsor when ownership interests in a business, subsidiary, or division are sold, transferred, or otherwise changed. If the pension plan later terminates, PBGC does not have authority under ERISA employer liability provisions to obtain recovery of any plan insufficiency from the original sponsor that existed before the plan changed hands. Where unfunded liabilities are transferred from a financially

strong to a financially weak sponsor, the risk of plan termination and exposure of the insurance program are substantially increased.

S. 1227 would amend ERISA to create a contingent liability extending over 10 years following business transfers by a plan sponsor or controlling business entity when unfunded guaranteed benefits of $500,000 or more exist at the time of the transfer. The bill would permit payment of the liability to be amortized over 15 years.

We are in general agreement with the changes in section 9 of S. 1227. Over 80 percent of PBGC's claims through fiscal year 1981 were incurred from plans with claims exceeding $1 million. Based on PBGC's past experience, the floor proposed in S. 1227 would apply contingent liability provisions to claims having the greatest impact on the insurance program.

SECTION 10 - ACTIONS REQUIRED OF PBGC

Section 10 of the bill requires PBGC to provide the Congress with reports that identify the feasibility of and alternatives for performing some or all of PBGC's functions in the private sector and for scheduling premium rates based on risk. These matters have periodically been the subject of discussion and debate in the pension community, and completion of studies proposed in the bill should identify available alternatives for more economical delivery of pension insurance.

Sincerely yours,

Milton J. Socolar

for Comptroller General
of the United States

Senator NICKLES. I might also mention that while I recognize there is a strong necessity for an increase in the premium, I also believe there is necessity for additional reforms, which we have hoped to encompass in S. 1227 as introduced.

At this point I will ask our witnesses to be brief. We have asked all of our panelists to adhere to a 5-minute rule. We go into session with three votes scheduled back to back at 10:15, and that will probably take well over an hour to encompass. It is my hope that we will be able to conclude this hearing prior to those 10:15 rollcall votes.

I thank everyone for your willingness to begin the hearing early this morning and for your willingness to be brief.

Our first guests are Mr. Ed Jones, who is Executive Director of the Pension Benefit Guaranty Corporation, and Mr. Jeff Clayton of the Department of Labor. We welcome you before this committee. Both of you are familiar with this committee and we appreciate your interest and input on this legislation.

STATEMENT OF EDWIN M. JONES, EXECUTIVE DIRECTOR, PENSION BENEFIT GUARANTY CORPORATION, ACCOMPANIED BY JEFFREY N. CLAYTON, ADMINISTRATOR, PENSION AND WELFARE BENEFITS PROGRAM, U.S. DEPARTMENT OF LABOR

Mr. JONES. Thank you, Mr Chairman. My name is Edwin M. Jones, Executive Director of PBGC. With me today is Jeffrey N. Clayton, the Administrator of the Pension and Welfare Benefits Program of the Department of Labor, who, you will recall, chaired the administration's task force in late 1982 on single employer issues.

I am pleased to testify before your subcommittee, and look forward to continuing to work with you to insure a sound future for the private pension guaranty program.

I understand your time is very limited this morning, but may I take a moment to note that Secretary of Labor Donovan, in his absence from the country and inability to appear in person today, has written you a special letter regarding the urgency of the speedy enactment of legislation to assure the financial integrity of our program.

With your permission, I would ask that his letter be entered in the record.

Senator NICKLES. It will be entered in the record.

[The following was received for the record:]

U.S. DEPARTMENT OF LABOR

SECRETARY OF LABOR
WASHINGTON, D.C.

JUN 13 1983

Honorable Don Nickles
Chairman
Subcommittee on Labor
Committee on Human Resources
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

I deeply regret that my absence from the country makes it impossible for me to appear before the Subcommittee today to present testimony on S. 1227. It had been my intention to appear with Edwin M. Jones, the Executive Director of the Pension Benefit Guaranty Corporation, and Jeffrey Clayton, Administrator of the Pension and Welfare Benefit Program, to present the Administration's views on legislation to amend the single-employer pension insurance program under Title IV of ERISA. In my absence, I am asking them to convey my thoughts to you as set forth in this letter.

I would like to reaffirm, in the strongest terms possible, my support for speedy enactment of legislation to assure the financial integrity of the termination insurance program administered by the Pension Benefit Guaranty Corporation. This program protects the benefits of approximately 30 million participants and their families and about 100,000 single-employer pension plans. As you are aware, the Corporation has suffered serious losses as a result of pension plan terminations in the past few years. It now finds itself in a deficit position, where its assets are one-third of a billion dollars short of the amount necessary to pay benefits that it has guaranteed to participants in terminated pension plans.

The current premium of $2.60 per participant per year is inadequate to provide sound funding for the PBGC. Continuing the premium at that level jeopardizes the entire insurance program. Last year, the Administration requested an increase in the premium to $6 per participant per year effective for plan years commencing on or after January 1, 1983. I renew that request on the most urgent basis at this time. Based on PBGC projections, the $6 premium will enable the PBGC to meet projected claims, pay administration expenses and retire the current $333 million deficit over a period of 15 years.

There is also an urgent need for legislation to protect the insurance system from absorbing unnecessary losses in connection with pension plan terminations by employers that are financially able to bear their own pension costs, or that have received funding waivers which they failed to repay. Details with respect to such legislation and relative facts and figures are being presented to the Committee by Mr. Jones in his testimony.

Mr. Chairman, I commend you for the leadership you have shown in proposing legislation to make the PBGC single-employer plan insurance program for private pensions sound and secure. You have my continued support in this important matter.

Sincerely,

Raymond J. Donovan

Raymond J. Donovan

Mr. JONES. Now, I would like to summarize the key points made in my longer written testimony which has been submitted for the record.

We submit to you, Senator Nickles, that the PBGC is at a crossroads in its pension insurance program which covers about 30 million participants. One road places the PBGC squarely on the course toward insolvency. The other road places the PBGC squarely on the road to solvency.

Now, the solvency road is obviously the one which has our support. We think it will assure our present 106,000 beneficiaries now holding promises to pay from us of about $3.3 billion that we will, with certainty, have enough money to pay them that $3.3 billion as the amounts become due.

Moreover, it will be perceived by our 30 million insured American workers as being a clear affirmation by Congress that the PBGC pension insurance program is going to be soundly financed and that, come what may, the PBGC guaranteed portion of their pension will be paid

Our proposed road to solvency is constructed of four main components and I will touch on them quite briefly. The first component is a $6 premium to become effective for plan years commencing on or after January 1, 1983. The administration strongly supports the need for a $6 premium.

Last year, we asked Congress for the same $6 premium at a time when our financial condition was much sounder than it is today. Since then, the need for that premium has increased for a number of reasons.

First, last year we had projected losses of about $74 million for the fiscal year ended September 30, 1982. That figure proved to be seriously low; losses turned out to be $220 million, of which $125 million reached us in the last few months of that year.

Second, last year we had projected losses for 5 future years of about $500 million in total. This year our loss projection for the next 5 years must give some recognition to the extremely heavy losses realized in 1982. Hence, our 5-year loss projection for the next 5 years is $600 million. We have maintained the slope at a 9-

percent increase, but we had to increase the amount since we are starting with a much higher figure as of the end of the year.

Third, PBGC had a deficit last year when we addressed you of about $190 million, which we had then projected would rise to about $236 million by 1982, calendar year end. Our actual deficit at the end of our 1982 fiscal year turned out to be $333 million, as opposed to $236 million, and that figure is estimated to be somewhat higher at this time.

Fourth, last year we thought we could retire our then projected $236 million deficit over a 5-year period with the $6 premium. Today, in the face of our much larger projected losses and our existing far higher deficit, it will now take us about 15 years to retire the deficit even if the $6 premium is authorized beginning January 1, 1983.

Fifth, our projection still does not make any allowance for unprecedentedly large claims. For these reasons and others, Senator, we believe that a $6 premium effective January 1, 1983 is essential. If the premium increase to $6 is delayed for even 1 year, we would never be able to retire our deficit with a $6 premium because the projected deficit would rise to $440 million by 1983 year end, and future losses, together with interest on the deficit, would absorb so much of the $6 premium as to leave nothing for retiring the principal of the deficit. A further delay in congressional action, therefore, can only endanger the system.

A second element of the administration's program is designed to avoid the increasing transfer of a plan's unfunded liabilities to the PBGC in a way which enables an employer to make a profit at the PBGC's expense, and hence at the expense of all other premium payers.

For example, suppose a company decides that it wants to terminate its pension plan at a time when it is $50 million of unfunded liabilities. Let us suppose further that at such time, 30 percent of the employer's net worth is $5 million. The employer would thus be able to transfer and to shed $45 million of liability for promised benefits and move them onto the PBGC insurance system.

From an economic viewpoint, that is essentially the equivalent of realizing $45 million in profit and the value of the company would rise correspondingly. Now, we think that a system which allows such a result to occur at the option of the employer is inequitable and unfair to the other premium payers.

The administration proposes that this situation be corrected by permitting the employer to transfer its unfunded liabilities—$45 million in that example—to the PBGC only under three conditions.

One condition would be that the unfunded liabilities can be transferred only if the PBGC determines that the company would be truly unable to continue in business if the plan were to be continued.

The second condition would be that the amount of PBGC's 30 percent net worth claim would have to be settled in advance before the PBGC would be required to take over the unfunded liabilities.

The third condition would be that the PBGC would be given a reasonable profits interest in the profits of the ongoing employer which would, if the company is profitable, enable the PBGC to recover the loss that it must assume on taking over the plan.

The PBGC, since its inception, has incurred $202 million of liabilities in this type of situation, and recovered only $62 million from employers, leaving a net loss to the PBGC of $140 million in that type of a situation. We think that Congress should recognize such equitable principles in determining when the PBGC must absorb losses.

We also believe that the proposed legislative changes set forth in S. 1227 would help the PBGC, and hence other premium payers, in obtaining a somewhat better recovery in reorganization cases. Our estimates indicate that we have absorbed $315 million of liabilities in bankruptcy reorganization cases, and have only recovered about 6 percent of that amount, leaving $295 million of losses to the PBGC. We would like to increase the 6-percent recovery figure.

We believe that the proposed legislation would be most effective with the least change from present law in protecting the PBGC and its premium payers. The same notice of termination as the present would be submitted by a plan administrator, along with certain additional information, to show that a plan termination is necessary in order to enable the employer to stay in business.

All cases in which plan assets are sufficient and that is 98 percent of the volume that we handle to pay guaranteed benefits would be handled in the same way they are now handled. Thus, only about 2 percent of our cases—the insufficient cases—would be processed under the proposed revision procedures.

A third component of the program relates to the granting of minimum funding waivers by the IRS under hardship conditions. The result of the granting of these waivers has been to impose much greater unfunded liabilities on the PBGC when a plan subsequently terminates after the waivers have been given and the amounts waived have not been repaid by the time of termination.

The economic effect of the waiver situation, as we see it, is that an employer benefits by, in effect, receiving the equivalent of a loan from the plan for the amount waived. Now, we think the plan should be given the right to obtain adequate collateral at the time a waiver is given so that the plan, and hence the PBGC, if the plan terminates later, will be given at least equal protection with other lenders, such as banks and insurance companies, at the time the waiver is granted

A fourth component of the administration's program relates to the transfer of plan liabilities through spinoffs or other changes in corporate structure. Such spinoffs or changes can result in one company shifting its unfunded plan liabilities to another company which is much weaker financially than the first company. The second company then terminates the plan. Even though not intended, under the law the first company may no longer be liable to the extent of 30 percent of its net worth, and the PBGC would then have a right to recover only 30 percent of the much lower net worth of the weaker company. We think that type of transfer of liabilities onto the PBGC should be clearly outlawed.

Another situation may involve a transfer by a parent of a part of its stock ownership of a subsidiary company so that it continues to own just under 80-percent of the stock of the subsidiary, and thus avoids a liability for 30 percent of the greater net worth of the

parent company employer sponsor, should the plan of the subsidiary be terminated.

We think that while the 80-percent test may be of value and pertinent for Internal Revenue Service purposes, the proper test for PBGC liability purposes is whether or not the parent company has effective control of the subsidiary company, and effective control, as we see it, occurs when the parent company owns more than 50 percent of the stock of the subsidiary.

We estimate that about $96 million of our losses to date, or 16 percent of our total losses, have involved this type of transfer situation. Please keep in mind that the PBGC is asking for contingent transferor liability only when it cannot determine under regulations to be issued by the PBGC that the transfer or change does not increase the risk of loss to the corporation, and hence to the other premium payers.

Under such regulations, we expect that the vast majority of cases would never involve transfer liability of any kind. The proposed legislation would also exempt situations in which the unfunded vested liability at the time of transfer or change is less than $500,000. We estimate that such an exemption would eliminate 93 percent of all plans from any involvement under the transfer proposed amendment, and would exempt 97 percent of the plans covering less than 250 employees, thus exempting almost all small business from any potential transferor liability under any circumstances.

Since the sums involved in cases subject to the transfer rules are likely to be substantial and involve only sophisticated employers with corporate actuarial and legal advice of high quality, we believe that the number of cases in which transferor liability will be imposed will be small.

We think that 10 years is a reasonable period in which to continue transferor liability for the limited number of cases that will be involved.

In the proposed legislation there has also been a recommendation for a study of the feasibility of a risk-related premium and also for a study on privatization. We think those are good studies and should be conducted.

We recommend that the committee proceed as promptly as possible to finalize a bill that will reasonably meet the administration's proposals, and we certainly stand ready to discuss with you and other interested groups and your staff proper methods of achieving this goal.

Thank you, Senator Nickles.

[The prepared statement of Mr. Jones follows:]

TESTIMONY OF EDWIN M. JONES

EXECUTIVE DIRECTOR

PENSION BENEFIT GUARANTY CORPORATION

BEFORE THE SUBCOMMITTEE ON LABOR

OF THE SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES

June 14, 1983

Good morning, Mr. Chairman and members of the Subcommittee. I'm Edwin M. Jones, Executive Director of the Pension Benefit Guaranty Corporation. With me today is Jeffrey N. Clayton, Administrator, Pension and Welfare Benefits Program, Department of Labor, who chaired the Administration's Task Force on single-employer issues. I am pleased to testify before the Subcommittee, and look forward to continuing to work with you to ensure a sound future for the private pension guarantee program.

Need for a $6.00 Premium for Plan Years Commencing on or after January 1, 1983

I want to reaffirm the Administration's strong support for a premium increase for single-employer plans. We are at a crossroads in the history of the pension insurance program for about 30 million American workers. The road that we urge Congress to take would place the PBGC on the road to solvency and will assure our being able to pay guaranteed benefits as they fall due. The other road leads to insolvency. We need an increase to a

level of $6.00 per participant per year, effective for plan years commencing on or after January 1, 1983 in order to put the insurance program on a sound footing. In addition, there are critical changes which need to be made in the single employer program if we are to avoid the abuses which have lately become such a drain on the system. My remarks today will address both of these legislative goals.

Last year I testified before this Subcommittee in support of the Administration's request for a premium increase. The last Congress took no action on that request. A year later, PBGC's needs have become more critical, and expeditious legislative action is essential.

Since I last testified, the financial condition of the single-employer pension insurance program has deteriorated. Losses from terminations occurring in the fiscal year ending September 30, 1982, were grossly out of proportion to any other year in our eight-year history. They totalled over $220 million, equal to over $7 for each of the about 30 million participants in insured defined benefit pension plans in 1982, well above the $2.60 premium level. On a cash basis alone, PBGC's annual benefit payments have increased dramatically. They currently are running at a rate of almost $150 million per year, or about $5.00 per participant. In light of these figures, the current $2.60 premium is not enough to carry the insurance program.

With such a premium, the PBGC cannot assure the over 106,000 workers in terminated plans who are already retired or who have

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vested benefits payable in the future that the $3.3 billion in benefits owed to them can, with certainty, be paid. It is for this reason that we are asking Congress to take prompt action to make sure that the $3.3 billion of outstanding promises to pay can be honored.

We are delighted, Senator Nickles, that you are holding this hearing to receive the views of all interested parties on the subject.

Underpinning for a $6.00 Premium

The underpinning for our recommendation to Congress that the premium be increased to $6 per participant per year is not complicated, either from a policy viewpoint or a dollars and cents viewpoint.

From a policy viewpoint, we are guided by the realization that PBGC is, among other things, a trustee for present and potential claimants on the PBGC's insurance guarantee program. We need the appropriate tools with which to carry out that trust, including an adequate premium level to assure that our obligations can be met. A preeminent obligation of the PBGC, in accordance with one of the congressionally stated purposes of ERISA, is to maintain a sound system of insurance that will assure timely and uninterrupted payment of benefits to participants. At the same time we are also guided by another stated

congressional purpose which is to encourage the continuation and maintenance of voluntary private pension plans.

PBGC must also implement a third purpose of Title IV, which is to maintain the insurance system at the lowest premium level consistent with our other obligations. If we are to accomplish that purpose, we believe there are other amendments to the law which should now be enacted by Congress, the basic thrust of which are set forth in S.1227. I would like to comment more fully on these changes in a moment.

From a dollar and cents viewpoint, the need for a $6.00 premium is undebatable for a number of reasons. It has been augmented by the events of the last year. Thus:

1. Our deficit is huge. Our liabilities exceeded our assets by $333 million as of September 30, 1982, and that deficit has increased in the period that has elapsed from that date. Without a premium increase, effective January 1, 1983, we will not be able to pay all of the promised benefits as they come due and we will be on the road to insolvency.

2. Our losses are up sharply from the levels projected a year ago, when we first asked for a $6.00 premium. Our projected losses of $74 million for the fiscal year just ended proved woefully low. The actual losses from terminations in that year proved to be $220 million, of which $125 million reached us in the last few months

of our fiscal year. In making our current five-year projection from this date we have concluded that it is necesary to give weight to the fact of such a high single year loss figure in making projections into the future, but we have also concluded that one year's experience is not a sufficient justification for adjusting the trend line increase upward sharply. Instead we have concluded that a similar large loss would occur once every eight years. The result is a projected average loss figure for the next five years of about $120 million per year, or $600 million in total, as compared with the $500 million projected last year and reflected in our then request for a $6.00 premium. If the premium is left at $2.60, our deficit will increase to about $940 million by the end of Fiscal Year 1987.

3. Projected increases in future losses will absorb more of the $6.00 premium than it would have absorbed under our projections of a year ago. Thus, less of the premium will be available to apply towards retirement of the deficit, which is over $100 million greater than it was projected to be when we made our $6.00 request to Congress last year. The result is that it will take over 15 years to retire our present deficit,

rather than the five years that we recommended last year.

4. Our projected losses still do not allow for any losses which may be suffered by us on account of the termination of unprecedently large plans.

I would like to take a moment to compare the loss figures that we projected just about a year ago and the loss projections in our current forecast to justify our request for a $6.00 premium. The premium study as submitted to Congress last year projected losses for the four years 1983-1986 at about $387 million. Roughly speaking, that amounted to about $100 million per year, or about $500 million for a five-year period. The projection started at $84.4 million in 1983 and was projected upward at a 9% rate to $109.2 million in 1986. The 9% increase represented the trend line that had been developed in seven years of PBGC experience. Our actuarial calculations last Spring demonstrated that approximately $3.00 of the requested $6.00 premium last year would be needed to cover projected losses averaging $100 million per year for five years.

As I have said, our Fiscal Year 1982 losses of $220 million far exceeded the $74 million we had projected. In taking this into account, we changed our projections in such a way as to treat last year as an anomaly, and to spread the loss over the eight preceding years. Our current loss projection, then, for

the next four years is approximately $493 million, or about $120 million per year. Over a five-year period, projected losses would approximate $600 million, as compared to the $500 million that we projected last year. The $600 million would require approximately $3.75 per participant per year to cover projected losses.

A second part of the $6.00 premium is needed to retire the deficit now existing in the single-employer program. Last year we had forecast a projected deficit by the end of the 1982 calendar year of approximately $236 million. We advised Congress that $2.00 of the then-requested $6.00 premium would be required to retire that deficit over a five-year period. However, the actual losses from terminations for Fiscal Year 1982 were almost $150 million above our projections, increasing the deficit to $333 million as of September 30, 1982. Thus, almost a 50% increase in the deficit occurred in only one year. If we were to retire this deficit over a five-year period, we would need $3.00 for that purpose alone. However, we are continuing to ask for a $6.00 premium with the result that there will be only $1.40 of the $6.00 premium to retire the deficit. Thus, the deficit will be retired not in five years, but in fifteen years.

A third part of the $6.00 premium will, as last year, be required to cover administrative costs. If $5.15 is used to cover projected losses and debt retirement, only $.85 of the $6.00 premium will be left for administrative expenses.

Thus, in summary, the $6.00 premium will use $3.75 to cover projected losses over a five-year period, $1.40 to retire the $333 million deficit, and the remaining $.85 for administrative costs.

Retirement of the deficit in 15 years assumes that the $6.00 premium will become effective for plan years commencing on or after January 1, 1983. If the increase were to be delayed even one year to January 1, 1984, the deficit is forecast to be in the neighborhood of $440 million by the end of calendar year 1983, some $107 million above the September 30, 1982 level. At that deficit level, we would never be able to retire the deficit with a $6.00 premium. We would never be able to retire the deficit with a $6.00 premium because by 1987, the projected annual losses from terminations would then exceed the annual projected premium income (after allowing for administrative expenses and interest on the deficit) leaving nothing for retiring the deficit.

I urge Congress to act promptly to increase the single-employer premium to $6 effective for plan years commencing on or after January 1, 1983. Further delay can only endanger the system. The longer that Congress waits, the greater will be the required premium, and the more unmanageable the problem will become.

LEGISLATIVE CHANGES

Insurable Event

Mr. Chairman, I'd like to turn now to the other legislative changes necessary to prevent abuses and to ensure that the losses contemplated by the single-employer program are the kind that Congress intended. We need to end the "gaming" of the system that results when an ongoing employer terminates its plan, and makes a profit by transferring its liability for unfunded vested benefits to the PBGC at a bargain price -- 30% of the employer's low net worth.

Inherent in the fulfillment of the Congressionally stated purposes of Title IV is the concept that PBGC must also recognize and give heed to the interests of all premium payers. We think that the losses which the premium payers must absorb should be limited to those that cannot possibly be borne by the companies that contribute to the losses, and the recommendations which we make to you reflect that basic viewpoint. In trying to reach that result, we are prepared to discuss with your committee and the business and labor communities reasonable modifications in the Administration's proposals for the purpose of achieving Congressional objectives.

Under current law, because an employer may terminate its plan at any time, PBGC cannot prevent a termination which is timed to coincide with a period where thirty percent of an

employer's net worth falls drastically short of the unfunded guaranteed benefits in the plan. The insurance system is automatically subject to taking losses of any magnitude when an employer liquidates. It was not intended, however, to allow an ongoing employer to "dump" liabilities on all other premium payers. It is only reasonable that an ongoing employer pay for the unfunded benefits in its plan from its future profits rather than allowing the employer to manipulate the termination to avoid responsibility altogether. Manipulation is the antithesis of a properly run insurance system. It should not be permitted to go on in the context of the Title IV guarantee program.

In the last Congress, the Administration sought to remedy the problem of insuring manipulated claims by deleting the net worth limit on liability, by prohibiting termination of insufficiently funded plans until liquidation of the plan sponsor, and by making the PBGC's claim a general unsecured claim in bankruptcy. That approach met with criticism from many quarters. Opponents charged that the proposal would upset credit arrangements, and endanger the viability of small creditors. To meet these concerns, the Administration has reconsidered various possible ways to prevent abusive terminations. After careful study last fall, the Administration believes that one key to limiting the PBGC's losses from ongoing employers is to ensure that at the time of the proposed termination of an insufficiently funded plan, PBGC has the authority to reject the termination if it is abusive.

Under the proposal, PBGC would determine whether the plan sponsor is truly unable to continue funding its pension plans and continue in business. If so, the PBGC would take over the plan but only if it concludes an arrangement with the ongoing employer that would enable the PBGC to collect, either in cash or in promises to pay, the employer liability equal to 30 percent of its net worth. The method of calculating such 30 percent would not be changed from present law. In addition, the arrangement should provide for payment in cash or in secured promises to pay any outstanding unpaid contributions to the plan with interest. In short, the PBGC would be settling, before it is required to take over a plan and assume the related losses, its 30 percent net worth claim and other accrued obligations of the ongoing employer to the plan.

In addition, the Administration believes that an ongoing employer should not be allowed to walk away from the unfunded obligations of its pension plan, laying off accrued losses under the pension plan on to the PBGC and enriching itself at the premium payers' expense. Instead, PBGC should be allowed to retain, on behalf of all other premium payers, some share in the profits of the ongoing venture to make up the difference between 30 percent of net worth and the value of the plan's unfunded guaranteed benefits. Thus, the proposed legislation provides that the PBGC, before being required to take over a terminated plan, will receive a future profits interest in the profits of the ongoing employer, which will at least give the

PBGC a chance to recover the loss that it would be assuming. Such losses would be equal to the excess of the plan's unfunded guaranteed benefits at the time of termination (including costs incurred by the PBGC in terminating the plan) over the amount collected by the PBGC through its 30 percent claim on net worth and for unpaid contributions.

In short, protection would be assured to the PBGC to the extent of allowing it to refuse to assume liability for losses under a terminated plan where the employer, by terminating a plan, could otherwise shed its liability for paying unfunded plan benefits that it has promised to pay and transfer that liability to other employers. All of the other provisions of current law relating to the insurable event which trigger PBGC involvement would remain. Plan sponsors would still be able to terminate plans that have sufficient assets to fully fund guaranteed benefits, without requiring negotiations with the PBGC.

Furthermore, the right of an employer under present law to freeze its plan and cease benefit accruals would not be altered, so that an employer can, without any PBGC involvement, eliminate its annual cost for funding benefit accruals in the current and future years.

The PBGC has absorbed losses of $140 million under plans that have been terminated by ongoing employers which are not in any type of bankruptcy proceeding or liquidation process. For the future, PBGC would like to be put into a position where the need for terminating a plan can be demonstrated from a financial

viewpoint and PBGC will secure some possibility of recovering its losses through an interest in profits of the ongoing employer.

In addition, we believe the proposed legislation would result in some improvement in our recovery from employers that terminate their pension plans under reorganization proceedings. To date, about $295 million of PBGC losses have occurred in reorganization situations. In those cases, our recovery has been equal to only 6% of the total claims incurred by the PBGC for such cases.

The remaining $150 million in PBGC losses have occurred as a result of employer liquidation and the PBGC is unlikely to collect any more under this proposal.

I would also like to note that the Administration has dropped its recommendation that the 30% net worth limit on employer liability be eliminated. This was done in response to the expressed concerns from the business community that elimination of the net worth limit would adversely affect business' ability to obtain credit.

On balance, it is expected that an employer's incentive to terminate an insufficiently funded plan under present law, which produces a subsidy for the employer by eliminating a required charge against its future earnings, would be reduced if the proposed legislation were to be enacted.

We believe that the PBGC administrative expenses for plan termination would also be reduced under the new law because issues relating to the amount of the employer's net worth and

other facts which are now left hanging at the time of termination and which have led to costly administrative delays and litigation will have been settled in advance before the PBGC is required to take over the plan. Thus, the particular employer responsible for PBGC losses and additional costs would pay them, rather than other premium payers as is now the case. We believe that this proposal is not only protective of the insurance system but also the least intrusive on the majority of plan sponsors. Ninety-eight percent of the cases that are now handled on a sufficient basis would continue to be processed in the usual way. Only 2% of the terminated cases would be affected by the proposal, but these 2% would be processed in such a way as to avoid hits against the system that can now be tried by those seeking to game the system.

Conditions in Tax Waivers to Protect PBGC and to Place the Cost of PBGC Losses on the Employer That Causes Them

Another source of losses for the PBGC has come from the granting of minimum funding waivers by the Internal Revenue Service. Minimum funding waivers are granted by the IRS where an employer can demonstrate hardship, i.e., that its financial difficulties prevent it from being able to make the required contribution to the plan in that year. At the request of the PBGC, the IRS will place a condition on the waiver that makes the waived amounts due and payable upon plan termination. Thus, at that time, the plan, (and the PBGC as successor trustee),

would become unsecured creditors and take their place in line with all other unsecured creditors. Where the plan sponsor is in a bankruptcy proceeding, recovery for the plan is apt to be small. In addition, by the time the bankruptcy occurs, bank and insurance company creditors have secured their loans with substantially all of the bankrupt's assets, leaving little or nothing to satisfy the plan's claims for the unpaid amounts. In effect, a minimum funding waiver is simply a low-interest loan from the plan to the employer, given without security, to be paid back maybe, over 15 years. The result of these "loans" is that at termination, the unpaid contributions usually prove to be impossible to collect in full, and PBGC's losses with respect to the plan are concomitantly higher. Last year, three companies alone terminated their plans and dropped about $130 million of losses on the PBGC, reported to us that they had received waivers of about $45 million in the aggregate. Our losses with respect to many other terminated plans were also much higher because of waived contributions.

The Administration believes that the Internal Revenue Service continues to be the appropriate agency to consider waiving the minimum funding standards over which it has jurisdiction. However, if the waiver could result in a loss to the insurance system, it is our view that it should be granted only under conditions that will give the plan at the time of the making of the loan the same protection that a bank or insurance company

lender would require before they would make a loan. Such conditions might include a requirement that collateral be posted in favor of the plan. We expect that this statutory change will minimize the number of times that unpaid contributions will be uncollectible at plan termination. It will put the plan, as a lender, on the same footing as other lenders, and the plan would have far more assurance than it now has that the loaned amounts will be repaid. It is our view that Congress intended pension plans to provide for the retirement security of the plan's participants. It was never intended that plans be used by financially troubled employers as the least expensive bank available. Obviously, if the plan is protected by getting collateral, the PBGC would be likewise protected if it is later required to take over plan assets and plan liabilities on termination of the plan.

Contingent Transferor Liability

A third source of loss relates to abusive transfers. We do not think that such abusive transfers are within the intention of present law, but we believe that Congress should adopt explicit statutory language which closes potential loopholes in this area. A transfer abusive to the system may be contrived in a number of different fact patterns. An employer may leave a control group to insulate itself and other members of the control group from employer liability. An employer may spin off a divi-

sion or subsidiary with plan liabilities and cease to be a contributing sponsor of the plan, leaving a weaker plan sponsor to fund the benefits. Pension liabilities may be transferred to another company that is very weak and thinly financed. The law should be clarified so that a company may not sell off its losing operations, with their associated underfunded pension plans, to newly formed or highly leveraged companies, and thereby shed the liability for the benefits which accrued during the time it sponsored the plan. We estimate that such transactions have accounted for over 96 million dollars in losses, about 16 percent of our total losses since inception. Unless this abuse is explicitly outlawed by statute, the possibility that such losses (and the probability of PBGC lawsuits to contest the legality of the transfers under current law) will escalate is very real.

We have no intention of discouraging normal business transactions, or even transactions designed to rescue troubled operations. It is our view, however, that the cost of funding those liabilities should not be allowed to fall on other premium payers when the transferred operations fail. Nor should a strong company be able to manuever ownership in a weak company to less than the percentage test for common control in order to protect its assets against control group liability.

The Administration is recommending that after a transfer, the former plan sponsor and its control group remain contingently liable for a period of 10 years for the amount of the unfunded

guaranteed benefits as of the time of change. Our proposal would exempt transfers which do not pose a significant risk to the system. In this connection, the law should exempt transfers where the unfunded liabilities of all plans sponsored by the former control group did not exceed $500,000. We estimate that this exception alone would exempt about 93 percent of all plans, and over 97 percent of all plans maintained by small business. The Administration would further exempt cases where the new sponsor and its control group were financially as strong as the old employer, or sufficiently strong to fund the plan. What would remain covered then, would be situations where the risk to the PBGC is greatest. The vast majority of transfers would escape contingent liability altogether.

Some have argued that the ten-year contingent liability is too long and that the liability should be limited to a period of five years. We are concerned that such a five year limitation would serve to bring about the very losses that the transfer rules are designed to prevent by creating a bright line test which would be easy to circumvent. For example, suppose the employer has tranferred unfunded plan liabilities of $50 million in connection with shedding an unprofitable business operation. It would be to the advantage of that employer to lend sums for working capital of less than $50 million to the new company or to set up the transaction in such a way, at a cost of less than $50 million to the tranferring employer, that the new company would not fail for a period of five years. The larger the under-

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funding, the greater the incentive to set up the transaction in this way. The Administration believes that ten years is an appropriate period during which to provide protection to the insurance system.

The Administration is also recommending that the PBGC complete two studies in the next two years to explore the alternatives to the insurance system as it is currently designed. The first relates to a risk-related premium. Many have argued that strong employers that maintain well-funded plans should not bear the cost of escalating premiums needed to cover losses from less profitable or less responsible plan sponsors. The task is to design a system which accurately reflects the risk of loss to the PBGC, and which can be administered at reasonable cost to the insurance system and the premium payers. We are working on such a study, and we will release it to Congress and the public as soon as it is completed.

The second study relates to the privatization of the insurance system. To the extent that the private sector can do a more efficient job of insuring private pensions, there is no reason to have the government continue to play a role. We have already discussed with many insurance companies how their role in the PBGC system can be increased. Private insurance, insurance pools, and the mechanisms for making a private system work need study before the Administration is ready to take a position recommending a change. We believe that two years is an adequate length of time and we are ready to explore the possibilities

and pitfalls and to prepare a report of this kind. Input from the private sector will of course be sought and in fact the PBGC has done so.

Mr. Chairman, in conclusion I would like to restate the urgent recommendation of the Administration, the Secretary of Labor, and myself that action be taken soon. Expeditious legislative action is critical to the sound future of the system. Delay will only serve to create a bigger and unmanageable problem in the future.

Senator NICKLES. Thank you very much, Mr. Jones.

Is it your thinking that if the premium increase is not granted to be effective for January 1, 1983, calendar date plans and if that was postponed to 1984, or postponed where it would not encompass this year's plans, the $6 would not be sufficient and you would come back next year looking for an $8 or higher premium?

Mr. JONES. Yes. If the premium were not made effective for plan years commencing on January 1, 1983, we would be back for a premium that would be $8 or even conceivably more, depending upon what might happen in the interim.

Senator NICKLES. When do the plans that have their calendar year beginning January 1, submit their premiums to PBGC?

Mr. JONES. The premiums are due by the seventh month; that means by July 31. We are beginning to send out premium payment notices now and in those notices we have indicated that the present premium is $2.60, but that Congress is considering the possibility of additional legislation. We have therefore highlighted the possibility of sending out an additional bill, should Congress act on our request.

Senator NICKLES. If Congress acts beyond the seventh month, most employers that had the calendar year renewal date on January 1 will have already paid a premium of $2.60, and then PBGC would send out an additional premium notice for the difference?

Mr. JONES. That would be our thought, Senator, yes. We receive about 70 percent of the total premiums in the year for plan years commencing January 1, 1983, so that our big incidence of cash income comes at the end of July.

Senator NICKLES. If Congress should look at this legislation and say we want to go with January 1, 1984, would the $6 premium be sufficient?

Mr. JONES. No, sir, not to accomplish what we are talking about here.

Senator NICKLES. OK. I have been troubled and upset, over the fact that we see the amount of unfunded liability increasing this year. I think the figure that both you and I used was $333 million. That was at the end of your calendar year, which was, what, September 1982?

Mr. JONES. September 30, 1982, yes.

Senator NICKLES. Do you have any guess what that might be in September 1983?

Mr. JONES. Well, we try to keep very rough figures going through the year. And as of the moment, taking into consideration very substantial increases in income that we have received and some increase in the value of our common stocks, and the like, and value in our liabilities with current interest rates, we are now at about a $333 million deficit, and we would contemplate that that figure would be increased somewhat by the end of the year.

Senator NICKLES. So the market can continue to increase at a 20-percent annual rate and you may be able to keep it at the $333 million liability?

Mr. JONES. Well, we have done well on our investments, but I would point out that we follow the policy, and have since the inception, of marking our assets to market so that on bond values, even though they may be considerably less than cost, they would be marked at market. We therefore value our liabilities on a market basis to keep everything even, and that results in the asset increases about offsetting the liability increases that occur at the time of the interest rate changes.

Senator NICKLES. You do carry your bonds on what the actual market is?

Mr. JONES. Yes, sir, we do.

Senator NICKLES. With the termination procedure under the proposed bill that I have introduced, and you have mentioned, is it going to be that much more difficult for the overwhelming majority of private pension plans that wish to terminate their plans do so? Is this bill going to be a hardship on them?

Mr. JONES. We do not think so, Senator. We have about 6,000 terminations a year. All but about 140 or 150 of them are sufficient plans. They would be coming in in exactly the same way that they are coming in at the present time and they would be processed.

We do as little as we can on them and then they are really financed through the private sector, mostly by the purchase of insurance contracts. So, on over 98 percent of the termination cases, there will be business as usual.

With respect to the other number, the 140 or 150, we would contemplate that on the proposal we have indicated they would be coming into us with a notice of termination, exactly as it is now, but probably would be asked to submit along with it information to indicate that its losses over the last 3 years have been such and such or that it cannot stay in business; that its creditors are seeking to foreclose on it. There would be affidavits of creditors.

Those are usually pretty big cases and there would be some additional information to enable us to come to the conclusion that the only sensible thing in order to avoid throwing them into insolvency, which the creditors would do and not us, would be to allow the termination to occur.

We would take over the liabilities and then we would negotiate for a profits interest of a reasonable amount to pick up the unfunded liabilities that have been dumped on us in the case of the termination.

Senator NICKLES. For that 96, 97, or 98 percent of the plans, this would impose no additional burden and their terminations could proceed as rapidly as possible?

Mr. JONES. Yes, that is correct.

Senator NICKLES. Mr. Jones and Mr. Clayton, I appreciate your appearing before us.

Mr. JONES. Thank you very much, Senator.

Senator NICKLES. Our next group of panelists is from the Industrial Union Department of the AFL-CIO. They are Mr. Prosten, Howard Young, and Thomas Duzak.

Thank you for appearing before us. Please proceed and, if you could, be mindful of our time limitations. Your records, and all the records of our panelists, will be entered into the record in full.

STATEMENT OF RICHARD PROSTEN, RESEARCH DIRECTOR, INDUSTRIAL UNION DEPARTMENT, AFL-CIO, ACCOMPANIED BY HOWARD YOUNG, SPECIAL CONSULTANT TO THE PRESIDENT, UNITED AUTOMOBILE WORKERS; AND THOMAS F. DUZAK, DIRECTOR OF INSURANCE, PENSION AND UNEMPLOYMENT BENEFITS DEPARTMENT, UNITED STEELWORKERS OF AMERICA

Mr. PROSTEN. Senator, we appreciate your time constraints. We will skim through our statement as best we can.

The Industrial Union Department, which we represent here today, is composed of some 60 industrial unions whose members are largely factory workers. Most of them are represented by negotiated single-employer pension plans, thus our interest in the matter before your subcommittee.

The steelworkers, the auto workers, and others among our affiliates have consistently supported the goals which are embodied in ERISA, and were among the staunchest advocates of plan termination insurance when passage of ERISA was first being considered by Congress. Since then, we have continued to pursue the goal of income security for all workers during their retirement years.

For this reason, we join with members of the subcommittee, major employers, and other interested members of the private pension community in seeking legislative amendments which remove the incentive for some employers to avoid payment of their obligations to plan participants and shift unfunded pension liabilities onto the pension termination system.

In a moment, I will comment on S. 1227, but first I would like to set forth our principal policy objectives—things which we feel should be reflected in any legislative proposal that eventually tackles title IV.

First, we believe Congress has always intended that employers who establish defined benefit pension plans should continue to maintain those plans for as long as the employer is financially able to do so. Therefore, the primary objective of any legislation should be to provide strong disincentives for termination by requiring ongoing employers to continue to be obligated to plan participants for the full amount of their accrued benefits.

Second, any legislation should reduce the opportunity for employers to dump unfunded liabilities onto the PBGC. In other

words, in the event a plan is terminated, the PBGC should have an expanded right to recover the shortfall between plan assets and the cost of guaranteed benefits.

A third policy objective should be to assure the long-term solvency of the insurance system itself through enactment of an adequate premium increase.

S. 1227 does attempt to address the last two objectives, but we believe it is a bit inadequate in terms of covering the employer's obligations to plan participants and beneficiaries.

Furthermore, we believe that certain changes, particularly in the area of expanded PBGC discretion in determining the insurable event, are unnecessary, unworkable, and potentially disruptive to the successful operation of plans.

For these reasons, we oppose the enactment of S. 1227 as currently structured. We offer as an alternative the following guidelines for the reform of title IV:

One, freeze of accruals. An alternative to plan termination would be for sponsors to continue to be able to freeze the accrual of pension benefits in accordance with procedures currently in effect under title IV, subject, of course, to whatever contractual obligations they may have, including collective-bargaining agreements.

Even though pension accruals may cease, funding would continue and the PBGC phase-in clock would continue to run. Additionally, the plan sponsor and control group would continue to be obligated for the payment of all accrued benefits, including those which were not yet vested at the time that the plan became frozen. This would be true even in the case of so-called sufficient plans where plan assets exceed the value of guaranteed benefits under title IV.

Two, in the area of plan termination, which would also be subject to any collective-bargaining rights, we should produce additional protections for the PBGC, plan participants, and beneficiaries in cases where the employer remains in business. In the event the plan is terminated, the control group would continue to be liable for the difference between guaranteed benefits and plan assets up to 30 percent of net worth.

In addition, the control group should be required to pay any remaining shortfall out of future profits based on a fixed percentage of control group profits over a specific period of time to be specified in the statute.

Plan termination should not diminish the obligation of the control group to continue to pay for accrued benefits, including those which were not yet vested at the time of termination, as they become due, to the extent that such benefits exceed guarantee levels. This obligation would continue until liquidation of the control group.

We believe the approach to title IV reform outlined above would provide maximum protection against unnecessary losses for plan participants and the PBGC alike by imposing strong disincentives to termination of plans by an ongoing employer.

This proposal would also limit the involvement of PBGC in the business affairs of the employer, while affording the employer and collective-bargaining agents more flexibility to moderate pension costs, if necessary.

As contrasted to the scheme envisioned by S. 1227, this approach would not require the use of artificial barriers to termination, which themselves could eventually become subject to manipulation.

Finally, let me comment on some other subjects contained in the bill. With regard to the premium increase, representatives of our unions have previously testified before the subcommittee and strongly supported PBGC's request for a $6 premium. We believe the need for the $6 premium continues, and therefore we support the bill in this regard.

It is all before you in our written testimony. We have strong concerns with regard to transfer liability. We reject the need for a privatization study. I will submit for the record our thoughts about funding waivers, but let me read one sentence now.

We feel that whenever a funding waiver is granted, a lien should be granted in favor of the plan for 100 percent of the waived amount effective on the date of the waiver.

In conclusion, we reemphasize that the IUD and its affiliates are committed to the long-term growth of define benefit private pension plans and to the need for a stable termination insurance plan.

We congratulate the committee for its work. We hope to be able to continue to work with you and perfect a bill which will meet all of our needs. Thank you.

[The prepared statement of Mr. Prosten follows:]

Statement of the Industrial Union Department, AFL-CIO

By Richard Prosten, Research Director

On S. 1227

Single-employer Pension Plan Termination Insurance Improvements Act of 1983

Before the Subcommittee on Labor

Of the Committee on Labor and Human Resources

United States Senate

June 14, 1983

Industrial Union Department, AFL-CIO
815 Sixteenth Street, N.W., Washington, D.C. 20006
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Howard D. Samuel, *President*
Elmer Chatak, *Secretary-Treasurer*

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My name is Richard Prosten, I am Research Director of the Industrial Union Department of the AFL-CIO. The Industrial Union Department, with close to 60 affiliated unions, represents five and one half million workers, most of whom are covered by the terms of negotiated single-employer pension plans. Appearing with me today are Thomas Duzak, Director of the Insurance, Pension and Unemployment Benefits Department of the United Steelworkers of America and Howard Young, Special Consultant to the President of the United Automobile Workers.

On behalf of the IUD and its affiliates, I wish to thank you for the opportunity to appear before the Sub-committee and to express our views on S. 1227, a bill to amend the termination insurance provisions of ERISA.

By enacting the termination insurance program, Congress determined that workers should be insured against the loss of anticipated pension benefits due to business failures and other events which prevent an employer from continuing a pension plan. The Steelworkers, the Auto Workers, and other IUD affiliates have consistently supported the goals embodied in ERISA and were among the staunchest advocates of plan termination insurance when passage of ERISA was being considered by the Congress. Since then, we have continued to pursue the goal of income security for all workers during their retirement years.

For this reason, we join with members of this Sub-committee, major employers, and other interested members of the private pension community in seeking legislative amendments which remove the incentive for employers to avoid payment of their obligations to plan participants and shift unfunded pension liabilities onto the termination system.

While we are prepared to offer a number of comments on the significant provisions of S. 1227, I would first like to set forth the principal policy objectives which we believe should be reflected in any legislative proposal regarding Title IV.

First and foremost, we believe Congress has always intended that employers who establish defined benefit pension plans should continue to maintain those plans as long as the employer is financially able to do so.

Therefore, the primary objective of any legislation should be to provide strong disincentives for termination by requiring ongoing employers to continue to be obligated to plan participants for the full amount of their accrued benefits.

Secondly, any such legislation should reduce the opportunity for employers to dump unfunded pension liabilities onto the PBGC. In other words, in the event a plan is terminated, the PBGC should have an expanded right to recover the shortfall between plan assets and the cost of guaranteed benefits.

The third policy objective should be to assure the long-term solvency of the insurance system through enactment of an adequate premium increase.

While S. 1227 attempts to address the last two policy objectives, we believe it does not adequately cover the employer's obligations to plan participants and beneficiaries. Furthermore, we believe that certain changes, particularly in the area of expanded PBGC discretion in determining the insurable event, are unnecessary, unworkable, and potentially disruptive to the successful operation of plans. For these reasons, we oppose the enactment of S. 1227 as currently structured.

The IUD offers, as an alternative, the following guidelines for reform of Title IV:

1. Freeze of Accruals

As an alternative to plan termination, sponsors should continue to be able to freeze the accrual of pension benefits in accordance with procedures currently in effect under Title IV, subject, of course, to any contractual or other limitations arising under collective bargaining agreements. Even though pension accruals may cease, funding would continue and the PBGC phase-in clock would continue to run.

Furthermore, and most importantly, the plan sponsor and control group would

continue to be obligated for the payment of all accrued benefits, including those which were not yet vested at the time the plan was frozen. This would be true, even in the case of so-called "sufficient" plans (where plan assets exceed the value of guaranteed benefits under Title IV).

2. Plan Termination

Plan termination, which would also be subject to any collective bargaining rights, should produce additional protections for the PBGC, plan participants, and beneficiaries in cases where the employer remains in business.

In the event a plan is terminated the control group would continue to be liable for the difference between guaranteed benefits and plan assets, up to 30 percent of net worth.

In addition, the control group should be required to pay any remaining shortfall out of future profits, based on a fixed percentage over a specific period of time to be specified in the statute.

Plan termination should not diminish the obligation of the control group to continue to pay for accrued benefits (including those not yet vested at the time of termination) as they become due, to the extent that such benefits exceed the guarantee levels. This obligation would continue until liquidation of the control group.

We believe the approach to Title IV reform outlined above would provide maximum protection against unnecessary loss for plan participants and the PBGC alike, by imposing strong disincentives to termination of plans by an ongoing employer. This proposal would also limit the involvement of the PBGC in the business affairs of the employer while affording the employer and the union more flexibility to moderate pension costs if necessary.

As contrasted to the scheme envisioned by S. 1227, this approach would not require the use of artificial barriers to termination, which themselves could eventually become subject to manipulation.

Finally, we wish to comment on other subjects contained in the bill.

Premium Increase

Representatives of IUD unions have previously testified before the Subcommittee and strongly supported the PBGC request for a $6.00 premium. We believe the need for a $6.00 premium continues and, therefore, we support the bill in this regard.

Transfer Liability and Definition of Control Group

We strongly endorse the concept of imposing contingent liability upon employers who would otherwise be relieved of their obligations to a plan because of a sale, spinoff, division, or other business transaction.

We accept the concept, that many small business firms are entitled to exemption or other relief from these contingent liabilities.

Equally important is the need to expand the obligation of other employers within the same control group to be responsible to the participants for unpaid benefits and to the PBGC for unfunded liabilities. Therefore, we agree that the use of a 50 percent test for determining control group liability is entirely justified. Since 50 percent ownership generally constitutes control, this change should help to prevent employer manipulation.

Privatization Study

The IUD strongly disagrees with the proposal to study the possibility of private sector involvement in Title IV.

By enacting ERISA almost a decade ago, Congress determined that the protection of pensions was a matter of national social policy and that the federal government must bear the ultimate responsibility for continued payment of pension benefits.

Despite the existence of a few narrow deficiencies in the original legislation which have been discussed today, we find no basis for shifting any portion of this vital function to the private sector.

Conclusion

In conclusion, we wish to reemphasize the fact that the IUD and its affiliates are deeply committed to the long-term growth of defined benefit private pensions and to the absolute need for a stable and sound program of termination insurance.

Therefore, we appreciate the effort which this Subcommittee has made to develop Title IV reform legislation which might attract consensus support from all interested parties.

Although the IUD cannot support S. 1227 as currently structured, we offer our criticisms and proposed alternatives in a positive spirit which we hope will encourage Congress to find a workable solution to these most difficult problems.

Senator NICKLES. We appreciate your comments, Mr. Prosten.

Mr. Young, do you have a statement?

Mr. YOUNG. Only for questions, sir.

Senator NICKLES. Good; you have saved me 10 minutes, so you have made my day.

Basically, then, as I caught most of your comments, Mr. Prosten, you endorse many of the concepts of the bill. You recognize there are a lot of liabilities which are going to require the premium increase. You recognize the fact there has to be some tightening up so that the liabilities are not dumped on the rest of the participants contributing to the PBGC.

You had a few reservations about giving the corporation that much leeway in making their determinations on how some of these things would be worked out, is that correct?

Mr. PROSTEN. That is correct.

Mr. YOUNG. And if I may, Senator, we are also concerned that the bill before you only addresses the problem of cutting back on PBGC's protections and does not address the losses that participants have when plans terminate. There is a loss on both sides that we think the bill should correct.

Senator NICKLES. Would you want to elaborate on that a little bit further, Mr. Young?

Mr. YOUNG. Yes; the thrust of the proposal we have outlined to you is not to increase the guarantees which PBGC would provide, but to require that if an employer continues in business after terminating a pension plan or after freezing the plan, it must continue to pay the nonguaranteed benefits to the participants.

Presently, the employer is in a position to both leave PBGC with the liabilities and leave participants with less than their full benefits, and we think both sides of that loophole ought to be closed up.

Senator NICKLES. If the agreement is worked out to where PBGC's liability is limited but the plan continues, you would want to see additional accrual of benefits for those participants?

Mr. YOUNG. No; we would like to see the payment of the benefits which have already been accrued. Currently, if the plan is terminated, benefits which have already been accrued can be cut back to the guaranteed level.

Senator NICKLES. The benefits paid above the guaranteed level?

Mr. YOUNG. That is right, not by PBGC, but by the employer or the control group.

Senator NICKLES. How would the collection of the difference between the guaranteed benefits and the vested benefits be accomplished under your proposal?

Mr. YOUNG. If the employer simply froze the plan, it would continue to fund the plan as it does now under the usual IRS rules. If it actually terminated the plan, what we are suggesting is that, as a minimum, those benefits are paid as they become due, in effect, on a pay-as-you-go basis.

Senator NICKLES. By the employer?

Mr. YOUNG. By the employer. Obviously, if the employer wanted to fund it, that would be fine, but an absolute minimum ought to be that they are paid as they become due.

Senator NICKLES. Gentlemen, thank you very much.

I appreciate your appearance and your willingness to work with our committee as you have in the past. It is my hope that we will be able to work up something and move on it before too long. We appreciate the input you have given this committee. Thank you very much.

Mr. PROSTEN. Thank you, sir.

Senator NICKLES. Mr. Hacking, I see you are ready to go, so please proceed.

STATEMENT OF JAMES M. HACKING, ASSISTANT LEGISLATIVE COUNSEL, AMERICAN ASSOCIATION OF RETIRED PERSONS, ACCOMPANIED BY STEVEN ZALEZNICK, LEGISLATIVE REPRESENTATIVE, AMERICAN ASSOCIATION OF RETIRED PERSONS; AND RICHARD S. RASKIN, CONSULTING ACTUARY, THE WYATT CO., NEW YORK, N. Y., REPRESENTING THE ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS, INC.

Mr. HACKING. Thank you, Mr. Chairman. On my right and accompanying me is my colleague, Steve Zaleznick, who is one of our legislative representatives.

We are here representing the American Association of Retired Persons, which, as I am sure you are aware, has a mass membership now well in excess of 14 million persons aged 50 and older.

I shall submit the association's statement for the record and summarize in the interest of time.

AARP wishes to endorse the approach of S. 1227 in addressing the problems facing the PBGC. Obviously, the chief problem is lack of income and assets relative to present and future obligations. That problem is aggravated by the ease with which plan sponsors can shift obligations to the Corporation. This is especially so in the case of a sponsor with high unfunded liabilities and little or no net worth.

The problem is compounded by the authority which the IRS has to grant waivers from statutory funding requirements, thus exposing the PBGC to higher risk of loss. Problems also arise, obviously, in a situation where one employer transfers a plan to another financially weaker employer, which in turn terminates the plan.

S. 1227 addresses these problems in what we think is a very constructive manner. The $6 annual premium per plan participant for which section 6 provides is reasonable based on past experience and future projections.

Section 7, which will allow the PBGC to place a lien on employer assets at the time a waiver from funding obligations is granted by the IRS, will substantially reduce the risk of loss to the Corporation.

Section 9, which would create a 10-year contingent liability where a plan is transferred to another, should also help reduce the risk of loss.

Finally, section 8 will make it more difficult for an employer to terminate a plan with insufficient assets to pay basic benefits. With respect to section 8, I would raise two points for the subcommittee's consideration. Section 8(g) would give the PBGC discretion to allow termination when it is a matter of business necessity. We

think this business necessity allowance should be closely scrutinized to be sure that it is very limited in application.

Finally, 8(g)(3) requires the PBGC to take into account the interests of the employees, employer, and the Corporation in considering whether it has sufficient right to the future profits of the employer. However, we would note that the interests of retirees are sometimes distinguishable from the interests of employees. Therefore, we would urge that statutory guidance also be provided to consider the retirees' interests.

Because of the crucial role played by PBGC in the retirement income scheme, action to protect the Corporation must be taken very soon. If nothing is done soon, obviously the premium will have to be higher than the $6 premium for which S. 1227 provides.

AARP will work very closely with the subcommittee to obtain speedy enactment of this legislation. Thank you.

[The prepared statement of the American Association of Retired Persons presented by Mr. Hacking follows:]

STATEMENT

of the

AMERICAN ASSOCIATION OF RETIRED PERSONS

before the

SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES
SUBCOMMITTEE ON LABOR

on .

S. 1227, THE SINGLE-EMPLOYER PENSION PLAN TERMINATION INSURANCE IMPROVEMENTS ACT OF 1983

JUNE 14, 1983

I. Introduction

The American Association of Retired Persons appreciates the opportunity to appear before the Labor Subcommittee to endorse the approach to a difficult problem which is taken by S. 1227, the "Single-employer Pension Plan Termination Insurance Improvements Act of 1983." In sponsoring this bill, Chairman Nickels has offered a valuable step toward stabilizing the Pension Benefit Guaranty Corporation.

There are currently about 32 million participants in defined benefit single-employer pension plans who receive the assurance of the Pension Benefit Guaranty Corporation that a significant portion of their pension benefit will be paid to them even if their employer ceases to operate. While only a small portion of these participants will ever require the accistance of the PBGC, the insurance it provides to all participants is extremely valuable. Retirees who are paid promised benefits directly by the Corporation are even more cognizant of the services it provides.

The Association believes that the Pension Benefit Guaranty Corporation is confronted by a number of significant obstacles. While none of these obstacles is insurmountable, it is becoming increasingly urgent for Congress to resolve them expeditiously. If Congress fails to act, it runs the risk of turning the PBGC

into a pay-as-you-go entity, which over time will be unable to meet its obligations.

II. The Causes of the Pension Benefit Guaranty Corporation's Financial Difficulties

While the PBGC is not immune from harm caused by a malfunctioning economy, two additional areas of concern are more directly related to the PBGC, and are therefore more readily reviewable by this Subcommittee. The first problem is an insufficient income to the PBGC in the form of premiums paid by plan sponsors. The second area of concern is a legal structure which makes it financially attractive for some employers to shift their pension liabilities onto the Corporation.

According to the Corporation, it has a current obligation to pay benefits of $3.3 billion. This obligation has a present value of $1.2 billion, while the PBGC has current assets of only $875 million. Additionally, the Corporation projects that new claims between 1983 and 1987 will amount to around $100 million per year.

The current insurance premium is $2.60 per plan participant per year for single-employer plans. The Corporation estimates that this premium, in addition to covering existing claims and administrative costs, could only provide insurance for about $15 million in new claims a year. If the PBGC's projection for new claims of $100 million per year is close to accurate, it is

clear that the existing premium is insufficient to fund the insurance system.

The Corporation has suggested that a premium of $6.00 per participant per year would meet its funding needs if it becomes effective soon. The longer Congress waits to enact the premium increase, the less likely it is that the $6.00 will be a sufficient premium figure.

Even with a premium increase, the insurance system would still have some defects which need to be corrected. Since the passage of ERISA in 1974, it has become clear that the PBGC could be abused by some employers. Instead of being an insurer of last resort, the PBGC can be used as a means for some employers to avoid fully paying their pension liabilities.

Under current law, any employer may voluntarily terminate a pension plan and have the responsibility for paying guaranteed benefits transferred to the PBGC. The extent of the employer's liability to the Corporation is 30 percent of its net worth. For employers with high unfunded liabilities and little or no net worth, this option is financially attractive.

Additionally, current law allows plan sponsors to ask the Internal Revenue Service to waive statutory funding requirements. A decision by the IRS to do so increases the risk to the PBGC, because the employer could terminate the plan with insufficient assets to pay promised benefits. Another situation in which the

PBGC has picked up increased liabilities in the past occurs when employers transfer an underfunded plan to a weak sponsor, who then terminates the plan.

The problems which are evident in the single-employer termination insurance field can be alleviated by Congress. The Association believes that a response is needed to ensure the security of retirees' benefits as well as the health of the PBGC and the future of the defined benefit pension plan. AARP feels that S. 1227 provides many of the required solutions.

III. Specific Comments about S. 1227

S. 1227 makes a number of positive changes in the pension plan termination insurance system without resorting to cutbacks in the statutory guarantee level. Under current law participants in terminated plans can suffer significant benefit reductions, because the guarantee level can be lower than a participant's vested benefit level. The Association appreciates the efforts made in S. 1227 to keep the guarantee level constant.

The Association also strongly supports Section 6 of S. 1227, which raises the premium rate to $6.00 per participant per year, effective on January 1, 1983. As the figures from the PBGC indicate, an increase in premiums is urgently needed. A $6.00 figure is a reasonable price to pay for pension insurance. The sooner this fee is implemented, the greater the likelihood that PBGC's expenses can be met without creating a need for even higher premiums.

If liabilities continue to accrue to the PBGC without a concomitant increase in income to the Corporation, a potential will be created for major premium increases sometime in the future. Such an increase would have a harsh impact on defined benefit plan sponsors and the participants and retirees of these plans. A much preferred approach would be to implement the more modest premium request of $6.00 immediately.

S. 1227 will also help reduce the pressure for future premium increases by limiting the ability of many plan sponsors to transfer their liabilities to the PBGC. These changes should lead to fewer plan terminations, and the PBGC will be likely to recover greater sums from those employers that do terminate.

Section 7 of S. 1227 allows the PBGC to become more actively involved in the IRS decision to grant a funding waiver to a plan sponsor. The PBGC would be allowed to place a lien on the employer's assets at the time the waiver is granted. In the event that the plan is terminated, PBGC would then have an interest on which it is likely to collect. Under current law, the PBGC would have to wait until termination to assert its creditor rights.

Section 8 of S. 1227 would restrict the ability of an employer to terminate a plan that does not have sufficient assets to meet its obligations to pay basic benefits. Discretion is given to the PBGC, in Section 8(g), to allow termination when it is a matter of business necessity and if certain protections are provided for the Corporation.

The Association supports the intent of Section 8, which would prevent an ongoing employer from dropping a plan onto the PBGC. We believe the business necessity allowance should be carefully reviewed to be sure it is limited in application and is not used by sponsors as a means of avoiding their obligations to fully pay for the benefits they have promised. Also, we hope that the PBGC will continue to monitor those plans which are not allowed to terminate to be sure benefits are being paid by them.

One particular portion of Section 8 which we feel must be clarified is (g)(3), which requires the Corporation to take into account "the interests of the employees, employer and the corporation" when considering whether it has a sufficient right to the future profits of the employer. The interests of the retirees can often be distinguished from those of the employees, and we therefore urge that statutory guidance also be provided to consider the retirees' interests.

Section 9 of the bill imposes contingent liability for ten years on an employer who transfers a plan to a new employer. This provision prevents sponsors from avoiding liability by shifting the plan to a weaker employer. Maintaining contingent liability would require the original employer to be responsible for its funding deficiencies. The Association supports this provision and feels that this liability should be in place for at least ten years.

Conclusion

The Association believes that S. 1307 is a positive response to a threat to the viability of the Pension Benefit Guaranty Corporation. Because of the crucial role played by the PBGC in the retirement income scheme, action to protect the Corporation must be taken soon. ASPP hopes to be able to continue to work with the Subcommittee in support of its efforts to enact legislation that would improve the ability of the PBGC to protect pension plan beneficiaries.

Senator NICKLES. Thank you very much, Mr. Hacking.

Mr. Raskin, would you care to proceed?

Mr. RASKIN. Thank you. The APPWP is also very interested in reforming the insurance system and making it work in a better manner. If one accepts the premise of the PBGC that the PBGC is an insurance company in a commercial sense, one could understand many of the positions that it takes with respect to this bill.

However, I believe that that is not true, and we believe that that is not true. The PBGC is not an insurance company in a normal commercial sense. Rather, it is simply a transfer agent, providing a mechanism for a stronger group of employers to assure that the benefits promised by failing companies with insufficient plans will be paid.

The PBGC should be thought of merely as an administrator and guardian of the plan termination system. The PBGC has an interest in preventing the abuse of the system, and we share the interest the PBGC has in preventing abuse.

We believe, however, that there is another objective which should underlie any bill that is taken, and that is to prevent the insurance system from imposing unnecessary hardships on normal commercial transactions.

In its self-image as an insurance company, the PBGC does not necessarily share this latter concern. We believe that any premium increase should be effective as of January 1, 1984; that the transferor liability should be phased out over a 5-year period; that the insurable event should be fixed; and that plan sponsors should be able to terminate benefit accruals and the growth of vested rights while continuing to fund the plan.

We have heard that if the $6 premium is not made effective January 1, 1983, there will be a requirement that an $8 premium be effective on January 1, 1984; that is, a single payment of $3.40 missed in July of 1983 representing the increase in premium from $2.60 to $6 will be replaced by $2 starting in July of 1984 and continuing thereafter.

The mathematics simply do not work. Even if you assumed that there was another premium adjustment made 5 years later, you would need something like a 100-percent interest rate to make

those two things have qual present value. I think we are being blustered at.

Having a premium increase made so close to the time of payment in the middle of the year for which the premium has been budgeted is not generally good for the purpose of the pension system in its entirety, forgetting about the PBGC and the plan sponsors. It just has a negative impact on people who want to have plans if you have something like this happen right in the middle. Nobody likes to pay a bill that is past due and get a premium increase for a bill.

We also believe the proposal to prevent plan sponsors from dumping liabilities by spinning off subsidiary companies or selling them to others is unnecessarily restrictive. There are many reasons that businesses are sold. Most often, the purpose is not to dump defined benefit pension liabilities on the PBGC.

Any plan to prevent dumping, and we believe there should be one, should not prevent the sale of businesses. Typically, when a business is sold the seller seeks to be free of any involvement with the business. It could require the buyer to perform in a certain manner, but to supervise the business for 10 years—that is kind of tough.

The way it seems to work now, if the seller even does something to see that over the period of time the liability is liquidated, the purchaser can reinstate the liability by giving a benefit increase. And then in this proposal, the seller would be responsible for a liability that was paid off and was reinstated. That does not seem to work.

I think that if this would happen, businesses that had plans that would be affected would reduce the benefits over time by not granting benefit increases, and that would be not in the interests of the country or the benefit system, although it would help the PBGC from its self-image as an insurance company.

We really do not know what is the appropriate transferor liability provision which will stop abuse. For anyone to say that he does is for him to predict something that he does not have enough experience on.

What we need to do is get something that will work to protect the PBGC, while not impinging on the normal commercial system. And if we have to make an error, we ought to err in favor of keeping commerce unaffected. If we negatively affect commerce, it would be something that would affect the PBGC negatively as well.

It is something like an analogy to a doctor, perhaps. If he wants to treat an illness, he had better not kill the patient at the same time. And I am afraid that the 10-year nonreducing liability that the PBGC wants will really damage the private pension system, especially the defined benefit pension plans.

We also think that the PBGC should not be allowed to dictate terms to people who have to negotiate with them. We feel that there should be a hard trigger; that there should be rules under which the PBGC has to pay the insurance.

We think that if the PBGC becomes involved in the bankruptcy system—and we think it would do so by having to negotiate with lenders, and Mr. Jones described it as another lender with the banks and insurance companies—that would have a negative

impact on those companies that needed to go into some sort of reorganization even before a formal reorganization under the Bankruptcy Code.

The PBGC is providing a benefit that is there for a reason. The idea should not be to protect itself from having any future payments be made as a result of plan termination.

Finally, in order to allow employers to control the liabilities which they have to their defined benefit plans, we believe it is appropriate that plan sponsors be allowed to terminate their plans in all aspects, except that of making required contributions. This is the so-called deep freeze. They would have the ability to extinguish benefits which have not yet become guaranteed under the law, and will be no less than the power to create such benefits which they have.

Under this proposal, employers would be allowed to freeze the additional accrual of benefits, including the counting of additional service for determination of the amount of the benefit, the amount of the guaranteed benefit, and the amount of service for determining whether or not an employee is vested.

Thank you.

[The prepared statement of Mr. Raskin follows:]

STATEMENT OF THE

ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS, INC.

BEFORE THE

SUBCOMMITTEE ON LABOR

OF THE

SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES

Tuesday, June 14, 1983
Washington, D.C.

Mr. Chairman and Members of the Subcommittee, my name is Richard Raskin, I am a consulting actuary with the Wyatt Company in New York. I am here today representing the Association of Private Pension and Welfare Plans, Inc. (APPWP). The APPWP is a non-profit organization founded in 1967 with the primary goal of protecting and fostering the growth of this country's private benefits system. The Association represents some 600 organizations located across the United States. Our member firms include hundreds of plan sponsors -- both large and small employers alike. Additionally, our membership includes leading organizations from every element of the employee benefits community which supports the nation's private benefits system: investment firms, banks, insurance companies, accounting firms, actuarial and benefit consulting firms, and various others associated with employee benefit plans. Collectively, APPWP's membership is involved directly with the vast majority of employee benefit plans maintained by the private sector.

American industry views the creation of the Pension Benefit Guaranty Corporation ("PBGC") and the insurance system it provides as a necessary addition to the private pension system. Now, plan sponsors can creditably promise that basic benefits will be paid to their employees regardless of the fortunes of the plans or their sponsors. While the PBGC provides a guarantee of benefits to plan participants it

should not be thought of as an insurance company. Rather it is simply a transfer agent providing a mechanism for stronger employers to assure that the benefits promised by failing companies with insufficient plans will be paid. The PBGC often characterizes itself as an insurance company to justify positions it takes with respect to proposed legislation. It is not an insurance company. Unlike insurance companies it does not have to compete with others in the market place or convince prospective purchasers of insurance that the purchase of coverage is financially desirable. The PBGC is administrator and guardian of the plan termination insurance system.

The PBGC as guardian of the insurance system has an interest in preventing its abuse. We share this interest of the PBGC in preventing abuse of the system. We believe, however, that there is another objective which is to keep the system from imposing unnecessary hardships on normal commercial transactions. In its image as an insurance company, the PBGC does not necessarily share this latter concern.

We generally applaud the introduction of S. 1227 and we are particularly satisfied to see that the legislation has been kept simple and that the bill eliminates potential abuse under the system by preventing solvent plan sponsors from dumping unfunded liabilities on the PBGC, or spinning off underfunded plans to poorly capitalized purchasers. Unfortunately, however, certain provisions of the

bill conflicts with industry's ability to do business in a reasonable and organized manner. In particular, we believe (1) that any premium increase should be effective January 1, 1984, (2) that the transferor liability should be phased out over a 5 year period, (3) that the insurable event should be fixed and (4) that plan sponsors should be able to terminate benefit accruals and the growth of vested rights while continuing to fund the plan.

What is in dispute here is the amount of the premium increase as well as the effective date of any such increase. Sufficient data is still not available in the public domain for those outside the PBGC to say that a $6.00 premium is appropriate. If Congress adopts a $6.00 premium, there would be a $3.40 per participant increase over the old premium. This represents over a 100% increase in the current premium. The APPWP believes that any increase in insurance premiums must be supported by reasonable projections of the PBGC's liability exposure and, accordingly, believes that the assumptions and analyses underlying any proposed increase must be made available for public review and comment before any increase in premiums is adopted. There is a further dispute as to when such premium should become effective. The PBGC claims a January 1, 1983 effective date is essential. We have heard that if a $6.00 premium is not made effective January 1, 1983 it will be necessary to have an

$8.00 premium effective on January 1, 1984. That is, a single payment of $3.40 in July of 1983 will be replaced by an additional $2.00 starting in July of 1984 and continuous each year thereafter. One could argue that the additional $2.00 in premium would not be in perpetuity but would only be in effect to the next time the premiums were increased. If the premiums were increased, say, January 1, 1989 an interest rate in excess of 100% would be required to justify the argument for an $8 premium in 1984. We do not believe any agency of government including the administration and Congress would tell us that economic conditions would justify interest rates of that type.

We believe it is in the interest of the private pension system, without which the PBGC has no purpose, that any premium increase be prospective.

We also believe that the proposal to prevent plan sponsors dumping liabilities by spinning off subsidiary companies or selling them to others is unnecessarily restrictive. It is common that businesses are sold. A sole proprietor may determine that it is time for him to retire or a large conglomorate may decide to redirect management efforts into areas with which they are more comfortable. There are myriad reasons that businesses are sold. Most often the purpose is not to dump defined pension benefit liabilities on the insurance system. Any plan to prevent

dumping, and we insist there should be one, should not prevent the sale of businesses. Typically, when a business is sold the seller seeks to be free of any involvement with the business. It could require the buyer to perform in a certain manner. But it is highly unlikely that he will be in a position to supervise the purchaser for a 10 year period. We believe a 10 year cliff transfer of liability provision as contained in S. 1227 would hurt business.

As a result employers would take steps to avoid being confronted with defined benefit pension plan liabilities in the event of a sale by terminating them in sufficient status or by never improving the benefit. There are two principal types of defined benefit pension plans - final pay plans and flat dollar plans. Final pay plans generally cover salaried employees and have sufficient assets to provide guaranteed benefits as future benefit increases because salary increases are anticipated when determining the amount of contributions to be made under the plan. Flat dollar plans generally cover wage employees. Often under the flat dollar plans there are insufficient assets to provide guaranteed benefits after a benefit increase is granted because such improvements are not anticipated when initially determining contributions. As a result of imposing prolonged contingent liability on transferor employers, many employers who truly cannot exclude the possibility that they will be

transferors, and who would otherwise do so, will refrain from granting benefit increases to rank-and-file employees under flat dollar plans in order to avoid increasing unfunded liability.

Again from its self-image as an insurance company, the PBGC may view a decrease in benefits under defined benefit plans as neutral or even positive. We must not give undue attention to the pernicious view that the PBGC is an insurance company. Instead, we must view it as a transfer agent, a component of the private pension system, which should promote commerce.

No one knows the appropriate transferor liability which will provide sufficient protection to the insurance system without unduly impinging on normal commercial transactions. We are fairly certain that the provisions of S. 1227 are too harsh with respect to commercial transactions and believe that business would prefer to choose being too lenient on the plan sponsor who desires to dump on the system and at the same time not impact negatively all employers' ability to sell businesses. If one believes, as we do, that this so called insurance system is simply a mechanism for employers to transfer liabilities between themselves, Congress should, and must take a less harsh position to satisfy business' ability to do business. We believe that

on the occurrence of an insurable event, liability for unfunded guaranteed benefits should be primarily allocated to the employer maintaining the plan at the time of such insurable event. If such employer does not have sufficient assets so that 30% of its net worth covers the liability for unfunded guaranteed benefits, such liability should be secondarily allocated among all employers who contributed to the plan during any portion of the five year period preceding the year in which the insurable event occurs.

Thus, a seller desirous of limiting his liability can do so by insisting the buyer contribute to the plan under a funding schedule more rapid than that required by ERISA. Under S. 1227 any unseen fortuitous event occurring over a 10 year period could result in the seller's liability being reinstated even if the plan became fully funded in the interim. Proponents of the 10 year cliff rule point out that a seller can protect himself simply by retaining the assets and liabilities. It is our contention that that is not as simple as it seems. There may be labor agreements which prevent this approach or other sound business reasons making this approach less than desirable. Proponents of the 10 year cliff approach also point out that they would construct a series of safe habors. Safe habors very often are in unchartered waters which cannot be relied upon in advance of a transaction. And we believe they do not provide a

satisfactory answer to many business transactions which would be carried out without the intent of dumping on the PBGC.

It is our belief that requiring PBGC agreement to terminate an insufficient plan would allow the PBGC to enter into re-organization attempts prior to or during a re-organization in bankruptcy. This would allow the PBGC to improve its creditor status or force lender's to withdraw support at relatively early stages.

We believe the proposed soft trigger will lead to many undersirable effects. Lenders may modify loan agreements to provide that loans are in default on the filing of an application for plan termination coverage. Certainly, you would want to bar such conditions in loan agreements if the soft trigger approach is to be utilized. An even more insidious event may be the plan participant's failure to receive guaranteed benefits in a plan sponsored by a bankrupt corporation which will be prevented from negotiating with the PBGC by its creditor's.

While we concur that the provisions of current law which allow the insured plan sponsor to declare under what circumstances the insurance will become effective is inappropriate, we believe it is equally inappropriate to allow the insurer, the PBGC to make such determination. We favor a more objective standard to determine the insurable event.

The APPWP believes that it would be appropriate for an employer to be able to shift plan liabilities to the insurance system when there is a final liquidation of the employer. We also recognize, however, that there may be other legitimate events, such as receipt of a specific number of funding waivers or other extreme financial hardship, which could serve as a trigger for a plan termination.

Finally, in order to allow employers to control the liabilities which they may have to their defined benefit plans we believe it is appropriate that plan sponsors be allowed to terminate their plans in all aspects except that of making required contributions. The so-call deep freeze. Thus the ability to extinguish benefits which have not yet become guaranteed under the law will be no less than the power to create such benefits. Under this proposal employers would be allowed to freeze the additional accrual of benefits including the counting of additional service for determination of the amount of the benefit, the amount of the guaranteed benefit and the amount of service for purposes of determining whether the employee is vested. Such a change in the law would have a salutatory effect on both employers who must fund accruals under their plan and the insurance system as a whole.

Senator NICKLES. Thank you very much, Mr. Raskin.

I have a couple of questions. Mr. Hacking, you made a suggestion that we look at the term beneficiaries in regard to (g)(3). We will take a look at that. How does your organization feel about the deep freeze proposal? Are you familiar with it? It was just recently touched on.

Mr. HACKING. Let me ask my colleague to respond.

Mr. ZALEZNICK. We have not had a chance to look through all the details, because it is something that has not come out on paper yet. But we would be willing to consider that as a way to get higher benefits to beneficiaries—something over the guarantee level. So, we are anxious to take a look at it when it comes up.

Senator NICKLES. I appreciate many of the comments that you made in your statement. Do you have any thoughts on whether or not the contingent liability should be 10 years, or should it be less?

Mr. HACKING. Mr. Chairman, 10 years seems reasonable to us. We have no cause to say that it should be more or less. Certainly there should be contingent liability and 10 years seemed like a good timeframe.

Senator NICKLES. Mr. Raskin, you mentioned in your comments that you had some serious reservations about some of the contingency liabilities, but you did think that there should be some. Maybe I am paraphrasing incorrectly.

Did you have a problem with the 10 years? Should that be shorter?

Mr. RASKIN. We think the 10 years ought to be reduced to 5 years. It is very difficult for anybody selling a business to protect himself for a liability taking place down the road.

For example, suppose the terms of the contract were such that the seller insisted that the buyer amortize the unfunded liability over a 3-year period and the buyer did so. One would think that under those circumstances, the seller ought to be free from any requirement.

If, in the third year, the buyer were to increase the benefits and now have a new unfunded liability having nothing to do with the seller at all, the way the bill is worded the buyer would impose a contingent liability on the seller. And if that came up in the ninth year and it phased in, he would be stuck.

Senator NICKLES. It is my opinion, and maybe I am not correct, that we did try and put in a few exemptions and then left a little leeway, possibly too much, for the PBGC to limit that liability to where, at the point of transition or where the transaction was made, if there was no greater liability to be imposed on PBGC, then——

Mr. RASKIN. It could not go back over the initial liability, but if the initial liability were worked off, then it can always go back up to that amount again.

Senator NICKLES. We are receptive to your comments and, hopefully, if that is the case then we will be able to come up with some language that would clarify that. Certainly, that is not our intention; I think you understand that.

Do you agree with the intent of the proposal to have some contingent liability which would prohibit the dumping cases, which I think Mr. Jones mentioned were as much as $96 million?

Mr. RASKIN. Oh, yes. We believe that is a very important factor. Last time that I testified, I think we insisted that there be some provision, and we still believe that there should be some provision. We just think that the provision going for 10 years is onerous and we think it ought to be worked off over a period of 5 years; not be a cliff, but be reduced over the 5 years in relationship of the amount of contributions that the two plan sponsors made to the plan in the 5 years before termination.

Senator NICKLES. You mentioned support for what most of us would call the deep freeze proposal. Would you care to elaborate a little bit further on that, particularly in light of the fact that we had some persons give the opposite side?

Mr. RASKIN. OK.

Senator NICKLES. Let me turn that question around. Will that not pull us back into some of the same dilemmas that we had with S. 1541, that I introduced last year; that we get into the question of net worth and limitations and the 30 percent and the creditor status?

Mr. RASKIN. Well, the only thing that would happen if we had the deep freeze would be that the employer could, if his collective-bargaining agreements allowed him to, stop the vesting clock from running. That would just reduce the amount of benefits that would be vested over a period of time.

It is not always true that the employer could do that on a unilateral basis, but the employer has the ability to create the benefit and to promise the benefit. And if he finds that the benefit that he promised was too great prior to the time that it is required that it become vested—and sometimes the promise of a benefit includes a payment for past service, and if he finds he cannot do that, he ought to be allowed to extinguish that before it becomes vested. I do not think that it would create any of the problems that we had in the last bill.

Senator NICKLES. Any additional comments?

[No response].

Senator NICKLES. Again I apologize for the fact that we are on a quick pace. We are already in session and, as I said, the first vote is scheduled in 20 minutes and we have another panel also.

I want to thank you for your presentations and also for your repeated interest. I recognize that both of you, and others of our panelists, have presented testimony to this Committee before and have indicated a willingness to cooperate. I solicit that cooperation and wish to say we appreciate it very much. We look forward to working with you again.

I will ask you this as a final question. You do recognize there is a serious problem that will probably necessitate an increase in the premium? You also at the same time, would like to see some reforms to eliminate abusive dumping on the PBGC along with that premium increase?

Mr. RASKIN. Yes, sir.

Senator NICKLES. Well, we certainly concur with that. Hopefully we will be able to formulate something that would be positive and productive, and not counter-productive on the general pension community and on industry as a whole. Certainly, that is counterproductive on the very workers who we are trying to protect.

I think with those mutual goals that have been stated by most of our panelists today, we should be able to come up with something. Your input is appreciated. Thank you very much.

On our next panel is Charles Bucy, assistant general counsel of LTV, representing the ERISA Industry Committee; Paul Jackson, vice president of the Wyatt Co., Washington, D.C., representing the National Small Business Association; and Don Phillips, director of employee benefits for Beatrice Foods, representing the National Association of Manufacturers.

Gentlemen, welcome. Mr. Bucy, please begin.

STATEMENT OF CHARLES L. BUCY, ASSISTANT GENERAL COUNSEL, THE LTV CORP., DALLAS, TEX., REPRESENTING THE ERISA INDUSTRY COMMITTEE, ACCOMPANIED BY GEORGE J. PANTOS, COUNSEL; PAUL H. JACKSON, CONSULTING ACTUARY, THE WYATT CO., WASHINGTON, D.C., REPRESENTING THE NATIONAL SMALL BUSINESS ASSOCIATION; AND DONALD W. PHILLIPS, DIRECTOR OF EMPLOYEE BENEFITS, BEATRICE FOODS CO., CHICAGO, ILL., REPRESENTING THE NATIONAL ASSOCIATION OF MANUFACTURERS, ACCOMPANIED BY RICHARD H. FAY, COUNSEL, AND PATRICIA CALLAHAN, DIRECTOR OF EMPLOYEE BENEFITS, NATIONAL ASSOCIATION OF MANUFACTURERS, A PANEL

Mr. BUCY. Good morning, Mr. Chairman. I understand that at least one of the votes which is scheduled for this morning is one of great importance to our country, and particularly to the States of Oklahoma and Texas. Therefore, I will do everything I can to get you there on time.

Senator NICKLES. Thank you. I appreciate that.

Mr. BUCY. I am Charles Bucy, assistant general counsel of The LTV Corp. in Dallas, Tex. I appear here this morning on behalf of the ERISA Industry Committee or, as it is sometimes referred to, ERIC. I am accompanied by George Pantos of the law firm of Vedder, Price, Kaufman, Kammholz & Day, counsel to ERIC.

With the Chair's permission, you have received my prepared statement and in the interests of time I would like to just summarize very briefly and extemporaneously the major points of that statement.

Senator NICKLES. Could you pull your microphone up a little closer so that the people in the back might be able to hear?

Mr. BUCY. Thank you. I also would be prepared at this time to answer any questions which you might have with respect to the prepared statement or to answer them later upon the submission of questions.

Listening to the witnesses thus far this morning, it appears to me that we have at least the appearance of a fairly broad consensus that something needs to be done. In fact, if I hear correctly, I hear only three significant points at issue.

One is the effective date of the premium increase; one is on transferor liability. Are we talking 5 years or are we talking 10 years? And the third is the discretion which would be afforded to the PBGC in what I call a distress termination case.

Going first to the premium increase, if I may be permitted a homely analogy, it seems to me that we are looking at a dam that has a hole in it; that is, the loopholes which permit some plan sponsors to dump their unfunded plan liability ostensibly on the PBGC but, in reality, upon the other premium payers.

If I heard the PBGC's testimony correctly, it is urging that we have to move immediately—indeed, retroactively—to keep the level in the reservoir level. It seems to us that, more importantly, we have got to plug up the hole and then see how much we need to keep the reservoir level.

For this reason, while ERIC endorses, albeit reluctantly at this point, premium increase to $6, we are proposing the establishment of a congressionally mandated and appointed group of outside experts to study the entire premium system. We think that that needs to go into all sorts of details.

For example, the actuarial assumptions which are used by PBGC and the budget office on determining their unfunded liability—why is it amortized over only 5 years when, under ERISA, employers have a much longer period over which to amortize unfunded liabilities?

We think there needs to be examination of the percentage of the total premium which goes for administration costs. As I understand it, at the present time under the $2.60 premium, 85 cents goes for administration. My friends in the insurance industry shake their heads in disbelief at that large an administrative cost as a percentage of the total premium.

So while, at this point, we reluctantly endorse the premium increase to $6, we urge that such a congressionally appointed and congressionally mandated study be undertaken and is results and recommendations be reported back to the Congress within 2 years.

Second, on closing the hole in the dam, the details of our recommendations are set forth in our prepared statement. To summarize generally, we, and we believe American labor, think that there should be more specifics either in the statute itself or in clear legislative history which would limit the PBGC's discretion in this area.

There should be clear standards which set forth the limited circumstances in which a distress termination could occur where the unfunded liability is permitted to be imposed upon the other premium payers.

Third, on transferor liability, we believe that the Congress needs to keep before it the fact that unfunded pension liabilities are a primary consideration only in a very limited number of the total sales or spinoffs of businesses in American commerce.

We believe that 10 years is too long a period for contingent liability to remain with the transferror. In 10 years, or in any substantial period of time, there are basically three things that can happen that would impact the situation that we are addressing and over which the transferror would have no control.

One is that the unfunded liability can go up through acts of the successor, whether it is a spinoff or a sale situation, over which the transferor has no control. No. 2 is that the pension assets standing behind those liabilities can go down through poor investment or fiduciary decisions on the part of the tranferee over which the transfuror has no control.

Third, the net worth of the transferred business standing behind the unfunded liability can go down through circumstances over which the transferor has absolutely no control.

In the transfer situation we believe that what the transferor needs most of all is certainty. He needs to have a specific number at the time he sells or spinsoff which he knows is his maximum liability so that his financial supporters will know what the worst case basis is.

For this reason, we believe that any contingent transferor liability must be measured as of the time of the transfer, and not be subject to the vagaries of what might happen ever over the next 5-year period by an entity over which it retains no further effective control.

That summarizes very briefly, Mr. Chairman, our statement. As I said at the beginning, I will be pleased to answer any questions, whether I covered them in this brief summary or not.

[The prepared statement of Mr. Bucy follows:]

STATEMENT OF

THE ERISA INDUSTRY COMMITTEE ("ERIC")

TO THE

SUBCOMMITTEE ON LABOR

SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES

ON THE

SINGLE EMPLOYER PENSION PLAN TERMINATION

INSURANCE IMPROVEMENTS ACT OF 1983

(S. 1227)

June 14, 1983

My name is Charles Bucy, Assistant General Counsel, The LTV Corporation, Dallas, Texas. I am a Board member of The ERISA Industry Committee (ERIC) and I am accompanied by George J. Pantos of Vedder, Price, Kaufman, Kammholz & Day, counsel to ERIC.

ERIC is an association of 119 major corporations concerned with national retirement policy issues. ERIC's members include approximately half of the nation's fifty largest industrial companies and represent a broad cross-section of the nation's largest retailers, utilities, bankers and insurers.

We are pleased to share our views with the Subcommittee today on certain problems which have developed in recent years

on the basic structure of the single employer termination insurance program. I would like to commend you, Mr. Chairman, for your continued strong interest in seeking a solution to these problems and, particularly for your sponsorship of S. 1227, which provides a useful framework to remedy the deficiencies in the present Title IV program.

Before offering specific suggestions, let me state at the outset that we believe the Title IV reform legislation should focus upon the following policy objectives:

1. The closing of loopholes in the current pension insurance system which permit solvent plan sponsors to transfer significant unfunded liabilities to the PBGC directly through voluntary termination or indirectly through spin-offs of poorly funded pension plans to poorly capitalized entities;

2. Financing of current funding deficiencies in the pension insurance system through a reasonable premium increase;

3. Encouragement of plan sponsors through a rational termination mechanism to fund and deliver benefits; and

4. To permit, under appropriate circumstances, relief for plan sponsors from the full pension obligation.

ERIC testified twice last year on the need for reform of the Title IV program. We continue to believe it is presently too easy for single employer plan sponsors voluntarily to end their obligation to fund defined benefit pension plans by terminating insufficiently funded plans and shifting financial obligations to the PBGC - and thus onto other employers who are paying premiums to the termination insurance program. Under present law, PBGC premium dollars are always available to fund those guaranteed benefits not provided through plan assets and employer liability, even if the terminating plan sponsor is continuing in business. Many employers have already found this loophole and the serious potential for continued abuse of the present law poses a serious threat to the financial condition of the Title IV program which is currently operating at a substantial deficit.

Insurable Event

We agree with many of the concepts embodied in S. 1227 which are aimed at overcoming present deficits in the Title IV program. Under S. 1227, plan termination would continue to be the insurable event. Employers with adequately funded plans could still terminate at any time without further liability.

However, in order to terminate underfunded plans, plan sponsors would have to meet stringent new tests and conditions to the satisfaction of the PBGC. We believe this new approach will tighten up the present law to make it more difficult for plan sponsors to transfer insufficiently funded pension plans onto the PBGC - except in the most compelling circumstances.

In other words, generally we agree with the concept that under certain circumstances the plan sponsor, should be permitted to terminate a pension plan and the PBGC should be required to assume the obligation to pay guaranteed benefits through the pension insurance system. Since this act has severe consequences upon plan participants, namely a cutback to guaranteed benefits, this action should be permitted only under circumstances of dire distress. We also agree that an ongoing employer who terminates a plan under these circumstances should be liable for the full unfunded guaranteed benefits. In addition to being able to collect up to 30% of the employer's net worth, the PBGC should be able to negotiate a future profits interest for any remaining unfunded guaranteed benefits which have been paid. However, we believe the criteria for termination should be made more specific and that plan termination should be permitted in certain clearly specified circumstances without PBGC agreement. Thus, we recommend that termination should be permitted after application by a plan sponsor under any of the following circumstances:

1. The attainment of three consecutive funding waivers under IRS hardship rules, or

2. The filing by the plan sponsor, or, in the case of a control group, by the predominant contributing sponsors of a Chapter VII liquidation proceeding under federal bankruptcy law or an equivalent act in a state court, or

3. A showing to the satisfaction of the PBGC of extreme hardship including affidavits by creditors and suppliers that absent the granting of a termination the creditors and suppliers are likely to compel cessation of all plan sponsor business activity which could, in effect, cause harm to plan participants and lead to larger PBGC losses due to the deterioration of employer net worth.

In the event the plan sponsor meets at least one of the above tests, the PBGC would be required to accept the termination at the time of application. In addition, as under current law, the PBGC would be permitted to retain the right to terminate involuntarily any pension plan under present ERISA provisions.

Funding "Frozen" Plans

At the same time, we believe it is essential to retain the flexibility necessary to encourage the continued growth of the private pension system while increasing the likelihood that benefits will be paid by the plan in all but the most compelling situations.

Since the plan sponsor carries the primary obligation to properly fund and deliver benefits as promised to participants, government policy should encourage the attainment of this goal. A plan sponsor who accepts this obligation should be permitted, as under present levels, to freeze a pension plan with the least possible interference from government. To accomplish this purpose, consideration should be given to amending the bill to clarify these existing rights.

As under present law, funding could proceed under current IRS rules or through any appropriate mechanism such as the purchase of annuities or use of a dedicated bond portfolio. Under this option, the PBGC would assume no obligation to pay guaranteed benefits and the plan sponsor would not be required to obtain PBGC approval. Notice to the PBGC would continue to be required. This approach would provide needed flexibility for plan sponsors while retaining the role of the PBGC as insurer of last resort.

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Transfer Liability

S. 1227 contains provisions that would impose contingent liability on an employer who shifts unfunded liabilities to the PBGC indirectly by the transfer of control of a plan prior to plan termination, to another business entity outside the control group. Such transfers are effected through sales of businesses, spin-offs and business reorganizations. Under present law, liability to the PBGC for unfunded guaranteed benefits is attributable only to the employer maintaining the plan on the date of plan termination.

To discourage the dumping of such unfunded pension obligations on financially weak entities, S. 1227 would impose contingent liability on a transferor for a 10-year period following the date of the transfer. While we agree that there should be reasonable contingent liability in transfer situations, the 10-year period represents a severe case of regulatory overkill. The need for such an excessive period of contingent liability has not been documented and will serve to unnecessarily impede normal business transactions. Thus, we suggest that the bill should be amended to provide a 5-year period of contingent liability.

Beyond the adjustment from 10 to 5 years as an appropriate time period, we also recommend that "safe harbors" be incorporated in the bill to eliminate contingent liability where it is not

necessary or where the liability is "de minimis". For example, a reasonable exception from contingent liability based on an appropriate level of unfunded vested liabilities of the plan transferred should be included in the bill. While this exemption would primarily benefit small business, it should apply regardless of the transferor's size. Additionally, the bill should contain an exception from contingent liability where the transfer does not create a risk of loss to the PBGC measured as of the time of transfer, i.e. in situations where the transferee is financially equal to or stronger than the transferor or where the transferee's financial condition is strong enough to cover the unfunded pension liabilities which have been transferred.

We also recommend that the control group definition should be amended to delete the provisions requiring that "common control shall be based on a common interest of more than 50%." The need to revise the present definition, which is also utilized for purposes of filing consolidated tax returns and for accounting purposes, has not been documented. We recommend that the present rule, whereby all trades or business under common control (using an 80% control test) are treated as a single employer, should be preserved.

We understood that there may be instances where the 80% test may have been abused. If you wish to address those cases,

a narrow definition of those entities affiliated with a control group which should be exposed to liability and the circumstances under which such liability would arise, would be a more appropriate solution.

Funding Waivers

We believe that funding waivers should continue to be granted by the IRS. However, the granting of a funding waiver should create a lien to the plan for 100% of the waived funds effective on the date of the waiver. Such waived amounts would continue to be amortized as under present law. We recommend that the bill be amended to authorize the IRS to issue regulations defining the PBGC role in the granting of funding waivers.

PBGC Premium

The proposal to increase the annual PBGC premium to $6.00 is of great concern to plan sponsors. ERIC has a substantial interest in the level of premiums since major plan sponsors, such as those represented in ERIC, pay approximately 85% of all premiums collected.

We are encouraged that the design changes in the single employer program which have been identified should contribute greatly to keeping future premiums at the lowest possible level. However, the proposal for a $6.00 premium represents

a five-fold increase in the premium requirement over a period of less than 7 years. In our May 19, 1983, testimony before this Committee, we expressed concern over the assumptions and methodology upon which the premium proposal was based and which produced a proposed 130% increase in the premium rate.

Accordingly, we recommend that an independent body reporting to the Congress study the methodology upon which the PBGC premium is calculated and that the results of the study be used to determine the amount of premiums payable in the future. The study should be completed no later than two years from the date of passage of this legislation. In the meantime, we would reluctantly support a premium increase to $6.00 as part of the legislation which has been developed to reform the single employer insurance program.

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Mr. Chairman, we thank you for allowing us to appear before you today and we will be pleased to answer any questions that you may have.

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Senator NICKLES. Thank you very much, Mr. Bucy; we appreciate it.

Mr. Jackson?

Mr. JACKSON. Senator, I am here today representing the National Small Business Association, which is a multi-industry trade association representing approximately 50,000 small business firms.

We sincerely appreciate the opportunity to present the views of small business to your committee, and we have found your staff indeed quite receptive to suggestions, to problems, and so on.

We have submitted a formal statement and I, too, would like to simply summarize some of the important things in it. I assume it will be printed in the record.

The small business group has had some reservations about the level of premium increase being requested. We had written, indeed, to Mr. Jones suggesting that since all of his figures being presented at this time were based on a September 30, 1982 date, it would be appropriate to update those figures.

There has been a substantial upturn in asset values since that time which my estimates indicate would have reduced their unfunded liabilities from $322 million to about $200 million. Indeed, if the funds had been invested in the same manner as private pension funds—two-thirds in common stock, one-third in bonds—the liability might be only $140 million at this point.

Indeed, a premium increase could be waived entirely if their concentration were focused on the investment of these funds and maximizing the return. A premium of $3.50, by my calculation, is sufficient today, accepting the PBGC's figures of last September and just adjusting them for the rise in asset value.

The transferor liability is a matter of particular importance to the small business community because small businesses are sold with a frequency that far exceeds that of big businesses.

We have suggested in our testimony that the proposal that all businesses that are sold should be liable to the PBGC for possible future loss, on the theory that some businesses are sold in order to dump things, is basically an un-American approach. It assumes that every seller of a small business, for example, is guilty and is going to be held liable for some period of time.

We would much prefer to have transferor liability limited to those cases and those transactions where a principal purpose is to evade or to avoid liability. The draft bill contains language of this sort in section 4064(A)(f), and so the PBGC, having been involved in the writing of that, must view that as a type of determination that they would make.

I do not believe anybody in the business community wants to stand up and defend the dumper, and that, in theory, would get at them. Putting the matter in context, however, Mr. Carroll gave me some statistical information which the PBGC had supplied him with.

Over the 7-year period from 1974 and the passage of ERISA, through September 1981, the PBGC was able to identify seven claims—that is one a year—but seven claims in that period where transferor liability was involved and where they might have, with this proposed language, avoided a liability of $49.3 million.

Now, $49.3 million sounds like a large number. It amounts to 23 cents per month in the employee premium, and that is something that is worthwhile saving if, in fact, you can. It is not a major contributor, however, to the rise in premium costs from $1 to $2.60 to $6.

There are now 90,000 single-plan sponsors. If you were to estimate one sale, spinoff, or similar transfer of pension obligation every 20 years, in the 7-year period involved there should have been 31,500 such transfers. And because seven of these are suspected of cheating, proposed legislation would have 31,493 worry about contingent liability so as to insure the PBGC against the bankruptcy of the buyer.

I think the figures are such that we ought to be focusing in on the place where the wrongdoing is and we ought to punish the wrongdoer. Those people whose only wrong has been to adopt a pension plan should be permitted to sell their business without contingent liability at all, unless they are doing wrong.

The reason is that when a seller sells his business, the price he receives is lower by reason of the liability of the pensions and by reason of the pension cost. In effect, he has already paid the full share of the pension liability in the selling process and should not have to pay twice.

Briefly, that sums up our testimony. We do appreciate the opportunity to be here. We recognize, in fact, from the changes made in the bill that you had hearings on last year that you and your committee are indeed receptive to suggestions and to the problems that have been raised, and we do appreciate that.

[The prepared statement of Mr. Jackson follows:]

STATEMENT OF PAUL H. JACKSON
ON BEHALF OF THE NATIONAL SMALL BUSINESS ASSOCIATION
BEFORE THE SENATE LABOR & HUMAN RESOURCES SUBCOMMITTEE ON LABOR
HOLDING HEARINGS ON S. 1227, SINGLE EMPLOYER PENSION PLAN TERMINATION
INSURANCE IMPROVEMENTS ACT
JUNE 14, 1983

Mr. Chairman and Members of the Committee:

My name is Paul H. Jackson. I am a consulting actuary with The Wyatt Company and am appearing here today on behalf of the National Small Businss Association (NSB), a multi-industry trade association representing approximately 50,000 small business firms nationwide. I sincerely appreciate the opportunity to present the views of small business on the proposed legislation, S. 1227, that would amend the single-employer pension plan termination insurance program. Legislation of this sort was proposed last year and, after much debate, was eventually tabled because it was simply too complex and far reaching in its impact to serve as a practical solution to the problems faced by the Pension Benefit Guaranty Corporation (PBGC). The legislation submitted currently is far superior to last year's bill, chiefly because those provisions that would have changed the very nature of the employer's obligation, and would have had a considerable impact thereby on the cost and availability of credit, have been deleted.

While this year's legislation is considerably simpler and more direct than last year's, we have strong reservations about the desirability of passing this as a law in its present form. Briefly, we find the following features in the proposed legislation unacceptable:

1. The PBGC continues to ask for a premium increase from $2.60 to $6.00. This is based on the figures as of September 30, 1982 at the close of a 12-month period with the highest business failures in the last 50 years, and prior to the 50% rise in market value of pension plan assets. If the requested premium were adjusted for nothing more than the rise in asset values over the last year, the PBGC deficit would be cut in half and the unfunded vested liabilities of the pension plans which PBGC insures would be more than cut in half. A $3.50 premium should be sufficient.

2. The proposed legislation extends the concept of common control to companies where there is a common interest of more than 50%. This is an unwarranted expansion of PBGC's authority to dig through all sorts of corporate records in an effort to come up with money to offset losses as they occur.

3. The legislation imposes liability on persons and corporations for up to 10 years following the sale of a business which involves the transfer of a pension plan. The sales price of a business with a pension plan will be lower because of the pension cost and liability. The seller should not have to pay twice.

4. Employers are denied the right to terminate pension plans unless they can demonstrate to PBGC's satisfaction that to continue the plan will force them into bankruptcy. Considering the usual length of time taken for PBGC to respond to matters, all of these employers will be bankrupt before they receive an answer.

Small business would welcome legislation that will strengthen the private pension system. It is not reasonable to focus, so single-mindedly, on the problems faced by PBGC as to ignore the problems that are created by the solutions that PBGC seeks. Derek Bok, President of Harvard University, in his recent report to the to the Board of Overseers, analyzed the current state of the law. This experienced trial lawyer and educator observed that most of our difficulty lies in the burdens and costs of our tangles of laws and legal procedures, and that the complexity of legislation and litigation seems to be increasing. The pages of federal regulations tripled in the 1970s alone, and yet none can be confident that our rules actually serve the public interest. Since laws seem deceptively potent and cheap they multiply quickly. Finally, he noted the troublesome results that follow the tendency to concentrate on the immediate case at hand, and the particular party aggrieved, while paying less heed to the effects of legislation or adjudication on a wider public. The proposed legislation suffers from precisely this problem -- it focuses so heavily on the problems of the PBGC as they stood in September of 1982 that they fail to take into account the massive effect which such legislation would have on

thousands upon thousands of totally innocent transactions taking place in our economy daily.

The most objectionable portion of the proposed legislation is that relating to the transfer of pension obligations from one person to another. Secretary Donovan's letter indicated that some employers have been able to shift responsibility for their pension promises to the PBGC by transferring their pension liabilities to a weak employer who then terminates and leaves the PBGC with unfunded liabilities. Some employers, unnamed by PBGC, have dumped undocumented amounts of liabilities on PBGC. This proposed legislation would make every employer who shifts responsibility for pension promises as an incidental part of selling a business operation, liable to the PBGC. This is simply unamerican. All sellers are guilty unless they prove themselves innocent. Liability in these cases should be limited to those transactions where a principle purpose is to evade or avoid liability. Indeed, this language is incorporated in Section 4064A(f) and thus the PBGC must view it as a type of determination which they can make.

We do not have any problem imposing transferor liability on people who transfer pension plans in order to evade the liability for their pension promises. The proposed legislation, on the other hand, would impose liability on the seller of the business as a result of events and decisions that are made by the buyer or that arise in the economy long after the sale has been completed and which obviously could not have been contemplated at time of sale. Consider two simple examples:

Case #1 The owner of a small business sells his company in 1983 to a buyer who fully funds the pension plan by 1988 but unfortunately in 1990 there is a substantial market downturn in the sectors in which the pension assets are invested, and due to bankruptcy of a large customer the business goes under in 1991. Is it really fair to impose a liability arising in this manner on the seller.

Case #2 An individual sells his stock to a buyer who manages the business in a sound manner. Several years later, a fire burns the plant down, and the buyer goes under. Should the seller really be responsible for this sort of thing? Should he buy fire insurance for the buyer?

There are far too many business sales taking place in the United States for perfectly innocent, normal and natural reasons, to impose upon all of them a set of requirements that implies that all employers selling businesses must be doing so with an idea of transferring pension liability. The current draft of the bill does exclude transfers where the liability is less than $500,000. This is merely a convenient political means of attempting to get small business to approve the legislation. Unfortunately, this part of the legislation is wrong in principle, not in the numbers. We urge you to amend this legislation so that the burdens of wrongdoing fall on those who do wrong and not upon all of those who adopt pensions for their employees.

In conclusion, small business appreciates the opportunity the Committee has given us to be heard on this matter. We are pleased that you have allowed us to present our views and look to your continued interest on this important issue.

Senator NICKLES. Thank you, Mr. Jackson.

Mr. Phillips?

Mr. PHILLIPS. Mr. Chairman, my name is Don Phillips and I am director of Employee Benefits of Beatrice Foods Co., which, incidentally, employs 550 people in the State of Oklahoma.

I am appearing here today in my capacity as a member of the National Association of Manufacturers' Employee Benefits Committee and as chairman of its pension subcommittee. Appearing with me are Richard Fay, a partner in the Washington law firm of Reed Smith Shaw & McClay; and Patricia Callahan, who is director of Employee Benefits at the National Association of Manufacturers.

I want to thank you for the opportunity to appear before the subcommittee. My comments will summarize the written material that was submitted earlier. I can basically say that I share the feelings of the fellow members of the panel and rather than repeat what has already been said, I would like to make a few more specific points on the issues.

One would be on the definition of a strong buyer in the contingent liability section of the bill. The concern here is more in terms of how do you define a strong buyer when you are a strong seller and you have a company with a high net worth, selling it to another company with a high net worth.

That particular definition should be spelled out and not be left to interpretation later on. So, strong buyer is one very important issue.

Another issue that is equally important to the NAM is the 10-year period of transfer liability. This is something that we find very difficult to accept, and would prefer a 5-year rule. We would also propose that the liability be phased out over a 5-year period of time at 20 percent per year.

We would agree to some form of contingent transferor liability, but 10 years is too long. We feel as though at that point in time, we would be subject to the whims of a future management that we would have no control over. It is a very difficult position to be in as a businessman trying to establish what your liabilities are at any particular point in time when they depend upon the actions of somebody else in the future.

Another item on transferor liability is that the bill should be very clear in defining exactly when a transfer of liability does exist. If you are in a situation where you truly transfer over an equal amount of assets to the liability under the plan, we feel as though there should not be any contingent liability that would be transferred or even recognized at that particular point in time. Maybe that is more a matter of clarification than anything else within the bill.

On funding waivers, write in another important provision, there is the question of who is going to determine when a funding waiver is given and how many funding waivers would be granted. The circumstances of this section need to be more specifically detailed.

While are all in favor of flexibility, in this situation, we think that the legistation should be more specific in its drafting.

On the matter of the premium increase, the other panel members covered the subject well. We have to accept an increase at this particular point in time, but in the future we would like to have the opportunity to be more involved in knowing the facts, and also in establishing what future premium levels will be as they come forward.

Lastly, the final point that I would make is in the definitions section of the bill. This is an area that is in great need of revision. The question that comes to mind there is why we are reestablishing or redefining some definitions in the law that were established a few years back that we have all learned to live with.

Senator NICKLES. Which ones?

Mr. PHILLIPS. Well, the definitions with respect to, say, multiemployer plans and things of that nature. Just generally, in our view, there are some areas in there that just seemed to be changed. I could ask one of my coileagues to be a little bit more specific on it.

Senator NICKLES. That is all right.

Mr. PHILLIPS. But probably the item in there that is of most concern to us is the proposed change from 80 percent ownership to 50 percent ownership in defining a control group. The tax law today, is basically set at an 80-percent ownership level and we think for consistency's sake, it is preferable to stay at the 80-percent level rather than reduce it to a 50-percent level.

This summarizes my particular comments with respect to the bill.

[The prepared statement of Mr. Phillips follows:]

National Association of Manufacturers

TESTIMONY OF

Donald W. Phillips

Director of Employee Benefits

Beatrice Foods Co.

on behalf of

The National Association of Manufacturers

on

S. 1227

Before the Labor Subcommittee of the

Labor and Human Resources Committee

United States Senate

June 14, 1983

1776 F Street, N.W. • Washington, D.C. 20006 • (202) 626-3700

Mr. Chairman and members of the Labor Subcommittee, my name is Don Phillips and I am Director of Employee Benefits for Beatrice Foods Co. I am appearing today in my capacity as a member of the National Association of Manufacturers' Employee Benefits Committee and as Chairman of its Pension Subcommittee. Accompanying me are Richard H. Fay, a Partner in the law firm of Reed, Smith, Shaw and McClay who is also a member of NAM's Employee Benefits Committee, and Patricia Callahan, the NAM's Director of Employee Benefits. The NAM is an organization of over 13,000 corporations of every size and industrial classification located in every state. Our members employ 85 percent of the workers in manufacturing employment and produce over 80 percent of the nation's manufactured goods.

We wish to take this opportunity to commend the Subcommittee and particularly you Mr. Chairman on your leadership in seeking solutions to the problems facing the single employer plan termination insurance program administered by the Pension Benefit Guaranty Corporation (PBGC).

Title IV of the Employee Retirement Income Security Act of 1974 (ERISA) established an insurance system to protect employees covered by private pension plans by guaranteeing a level of benefits in the event their pension plans terminated without sufficient assets to pay benefits. We recall during the decade

preceeding the enactment of ERISA, instances where employers were forced out of business and because their pension plans had not yet been fully funded, employees were left with little or no retirement income other than Social Security. We feel that the objectives of ERISA in protecting post-retirement income are as valid now as they were then.

However, with any law, there comes a time when it is appropriate to reexamine how effectively the system which it created is operating. We observe that the single employer termination insurance program is not immune to the effects of a severely strained national economy. We conceed that plan terminations are occurring at a higher rate than is desireable. And, we believe that plan participants and beneficiaries need to be assured that their pension benefits are adequately protected. This can be done by encouraging pension plans to be well funded and well managed.

Clearly, changes are needed to Title IV of ERISA. S. 1227 addresses the fundamental issues. While the NAM applauds the bill for moving in the right direction, we would like to comment on some of the specific problems we have with the pending legislation.

CONTINGENT TRANSFEROR LIABILITY

Provision: Section 9 of S. 1227 would create transferor liability for a 10 year period for the value of unfunded

guaranteed pension benefits. There would be two exceptions to the creation of transferor liability: one would be where the amount of the unfunded liability is less than $500,000; and the other would be where the transferee is financially stronger than the transferor so that the risk to PBGC would not be increased.

NAM Response. With respect to the transferor liability section, there are five points we would like to make.

First, the definition and circumstances determining a "strong buyer" must be set forth in the statute. It is too critical a provision to be left to PBGC regulations, if and when PBGC would promulgate them.

Second, transferor liability for a 10 year period is too long regardless of the circumstances. We would recommend at the outside that this period last no longer than five years and would prefer that the transferor liability be phased out over a five year period on a proportionately declining basis. Individual business conditions as well as the general state of the economy are too uncertain and unpredictable to justify a nexus to the transferor for 10 years.

Third, NAM believes that transferor liability should arise only when there has been a transfer of pension liability. Unlike what is mentioned in Secretary Donovan's letter of March 9, transferor liability would not be limited to situations where there has been a transfer of unfunded pension liability. For example, if a company having no pension plan of its own ceases to

be a member of a control group, that company would continue to have transferor liability for 10 years for the unfunded pension liabilities of any plan maintained by any member of the former control group. And it would follow conversely that all members of the control group would have transferor liability for any plan of the former member of the control group. NAM would seriously question the need for transferor liability where there is no increased exposure to the termination insurance system.

Fourth, NAM would suggest an additional exception to the transferor liability section of S. 1227. Specifically, even in instances where there has been a transfer of plan liabilities and where the $500,000 threshold is exceeded, when transferred assets equal the present value of accrued transferred benefits, there should be no liability.

Finally, the legislation needs to make it clear that transferor liability is fixed as of the date of the transfer.

MINIMUM FUNDING WAIVERS

Provision: Section 7 of S. 1227 would add a new section to Subtitle A of Title IV of ERISA. Specifically, it would provide PBGC with authority to set conditions on the granting of minimum funding waivers by IRS and would give a lien to the plan for the amount waived. The provisions of present law -- i.e. a one year waiver with the waived amount to be amortized over 15 years -- would continue.

NAM Response. NAM recognizes that the present system which has allowed IRS in the past to grant waivers without coordinating as to the effect on PBGC obligations is perhaps not wise. We believe that the two agencies should share responsibility in the granting of any waiver. However, S. 1227 as drafted leaves unanswered some very fundamental questions.

While the waiver would be for one year, as a practical matter, a company in continuingly poor financial shape might not be helped by only a single one year waiver. S. 1227 does not say whether it would be permissible to grant subsequent one year waivers with presumably subsequent amortization over an additional 15 years. If numerous waivers can be granted, then the repayment obligation of the employer could conceivably be stretched out indefinitely.

The operations and effect of the lien are also disturbing. While the lien would be granted in favor of the plan, the ultimate enforcer of its conditions is PBGC. The PBGC would be given extremely broad discretion in setting the terms and conditions of the lien. While flexibility is desirable, the bill needs to be specific on what guidelines PBGC would follow. We note that the lien would go beyond attaching to 30 percent of the net worth of a company and the potentially far reaching effects of the lien would have a serious effect on the credit standing of the company.

NAM opposed previous efforts to grant general creditor status to PBGC. We observed the adverse impact that would have on the credit worthiness of a company. However, the ramifications of the lien provision of S. 1227 would appear to duplicate those adverse conditions. We feel that any legislation needs to be specific -- as S. 1227 is not -- in outlining subrogation rights of various parties and when those rights are exhausted.

We would also like to observe the rather difficult and curious position in which this provision of S. 1227 would place plan fiduciaries. A plan administrator who is often an employee of the company and therefore responsible to management, would be required to enforce the conditions of the lien even if it meant forcing the company into bankruptcy. We doubt that plan administrators would welcome this "no-win" situation.

PREMIUM INCREASE

Provision: S. 1227 would raise the annual premium from $2.60 to $6.00 per plan participant effective for plan years beginning January 1, 1983. The bill would also provide for a two-year study on risk-related premiums.

NAM Response: NAM concedes the need for some premium increase to put the system on a soundly funded actuarial basis. However, we have some reservations on the manner in arriving at $6.00 and would like to have more information on the methodology upon which the computation is based.

On the matter of the study, NAM supports a reexamination of the present premium structure and would welcome the opportunity to work with the Administration during deliberations.

INSURABLE EVENT

Provision: Section 8 of S. 1227 continues present law for adequately funded plans and allows employers to terminate or freeze those plans at any time. However, under S. 1227 an employer would be permitted to terminate an insufficiently funded plan only if that employer proved to PBGC that termination was a financial necessity for the company to continue in business. Upon plan termination under such circumstances, PBGC would be able to collect not only 30 percent of the employer's net worth, but would receive a lien for the value of the unfunded guaranteed benefits and any previous waivers. PBGC would be able to negotiate the structure of the employer's debt to PBGC, including PBGC participation in future profits of the employer.

NAM Response: As presently drafted, S. 1227 would make it virtually impossible for most every employer to meet the so-called "hardship" test. We feel that the test must be broadened.

In addition, NAM would recommend that S. 1227 make it clear that an employer could get out from under a fixed commitment to a specific plan by allowing a freezing of future benefit accruals

while simultaneously permitting an employer to continue contributions on a aggregate cost basis until all obligations are satisfied.

DEFINITIONS

The bill creates an entirely new set of definitions dealing with an employer's relationship with plans. These definitions are substantially different from those in Title I of ERISA and are bound to create confusion. The Committee should explore with PBGC why these new definitions are necessary and what is being achieved that is not presently covered by the Title I definitions.

On a point of grave concern to NAM, S. 1227 would change the definition of "control group" by reducing the present 80 percent level to 50 percent. We note that present accounting rules use 80 percent and see no need to set up a different standard.

In any case, a careful reading of S. 1227 indicates that the new definitions are not used consistently. Therefore, it is not possible to determine what the drafters intended to do. Until these sections are clearer, we are unable to offer more specific comments.

SUMMARY AND CONCLUSION

NAM believes that the single-employer termination insurance program is in need of revision and that S. 1227 moves in the right direction. However, before NAM can give an endorsement of the proposed legislation, we would like to be assured of modifications along the lines which we have just outlined.

Senator NICKLES. Thank you very much, Mr. Phillips.

Mr. Bucy, you had many good comments. I think all of our panelists today have had some very good and thoughtful suggestions which we will be receptive in trying to address.

You mentioned calling for a congressional study to look at the entire spectrum of the premiums. I know that you are aware of the fact that in the bill we call for a study of whether or not it would be risk-related premiums, and also privatization of PBGC as a whole.

But you are calling for something more than that, looking for the percentage of premium dollars that is allocated to administration?

Mr. BUCY. That is right, and also the actuarial assumptions need to be studied for appropriations. But more importantly, we feel very strongly that there must be strong input from the private sector; that this should not be a PBGC study; and that all interested parties must be actively involved, including the premium payers and labor.

Senator NICKLES. The PBGC does not pay for these benefits. These benefits are paid for by the premium payers across the country, and that is something that I think needs to be reiterated on occasion.

I can also tell you that I share your concern for the percentage of premium that is going toward administrative expenses. You mentioned the figure of 85 percent. That will be one of the questions I will ask Mr. Jones. We will also be looking at what percentage it will be of any future premium increase, with an eye on trying to make sure that these are not out of line. It will be something that we will have greater input in on the congressional side.

Mr. BUCY. Mr. Chairman, I might have misstated that. It is 85 cents, according to the PBGC's statement, not 85 percent.

Senator NICKLES. There is a little difference between cents and percent. I was questioning that. I saw Mr. Jones over there starting to jump up and down. [Laughter].

Mr. BUCY. If he is not purple in the face, he never will be.

Senator NICKLES. There is a little difference between percent and cents. I appreciate your correction I misunderstood you.

On that same line, do you generally favor the concept of a risk-related premium?

Mr. BUCY. We think that it should have very careful study. When the premium rate was $1, we all could view it as a social cost of maintaining our own pension plans. As the premium escalates at the rate it has been doing over the past 8 years, this view loses its validity and the structure becomes inherently unfair to the sponsors of well funded plans for this reason, the need for and the downright rightness of a risk and exposure-related premium should be studied very carefully.

Senator NICKLES. I very much concur with that. There is a general consensus on this panel, as well as on other panels, that indicated some desire to see, possibly either statutorily or through the committee report language, a tightening up of the great amount of latitude that is now in the bill for PBGC, both in determination of liabilities, and contingency liabilities, et cetera.

Is that a correct assumption?

Mr. BUCY. Yes.

Mr. JACKSON. Yes.

Senator NICKLES. Any suggested changes by this panel or the other panelists who are still present—suggested language either for report language or statutory language—would be appreciated.

I think many of the comments particularly concerning the contingency liabilities and problems that could be in that area are pertinent and need to be addressed. It would be my intention to address them. It is certainly not this Senator's idea to have one employer who sells a business be responsible for additional incurred liabilities by the succeeding employer if he greatly increased benefits or mismanaged his pension funds or mismanaged the assets of those funds. We will want to clear that up.

Now, do you feel, Mr. Jackson, that the $500,000 exemption is sufficient? Would that take care of the majority of small businesses in America?

Mr. JACKSON. $500,000 would take care of a good many small businesses today. In fact, it takes care of most of the constituency of the National Small Business Association.

Our problem is that we disagree on principle. We think it is basically wrong, and if small business could be 100 percent exempt, we would still have the feeling that it was basically wrong. You should be punishing the wrongdoer rather than everyone.

If I could give you an analogy, the PBGC has indicated that they cannot be expected to prove dumping—prove intent to sell a business in order to rid itself of a pension liability.

Now, there were only seven of them that they found where they thought they had sufficient evidence to prove this. If we had a situation where people were speeding on Route 95, for example, and the police indicated that they could not possibly catch everyone, one solution is to close Route 95 up completely.

A second solution is to put a governor on every car so that it cannot go above a certain limit. A third possibility is to clock people on and off the road every time they come in, and so on and so forth.

But the real solution is to assume that most people are going to be honest, most people are conducting their businesses honestly, and that it is unnecessary. Whatever is done to the occasional case that speeds should serve as a good lesson for the rest of the community.

Similarly, I think if the PBGC could find a half a dozen cases—if a half a dozen cases exist, indeed—and they could prove dumping, they ought to take these people to the Supreme Court and they ought to throw the book at them. And that ought to be enough of a warning for the rest of the business community.

I guess my basic concern about the $500,000, getting back to the specific question, is $500,000 does a good job today, but we have a dollar that has a half life of about 5 years from now. The 500,000 probably exempts companies with fewer than 75 or 80 employees covered under the plan.

But 5 years from now, the figure will be 35 or 40 employees, and 10 years from now it will be maybe 20 employees. At this point, if 500,000 is put in today, it just does not work in the long run and we have something that has to be adjusted in the future.

Senator NICKLES. Are not most of the small pension plans, by and large, well funded by a very large percentage—like 90-some percent?

Mr. JACKSON. Most of the small pension plans are well funded. Indeed, in the course of the last year plans that have not been so well funded are suddenly better funded. And the actuaries working on the cases have seen the asset values rise to the extent that they are better funded.

But there are a lot of small employers that end up with negotiated plans which involve flat benefit amounts and which are continually upgraded, and those plans frequently are not very well funded—the union pattern plans. They do involve $5,000 to $10,000 of unfunded liability per employee in some cases.

Senator NICKLES. Certainly, this Senator, coming from a small business background, does not have any desire whatsoever to be punitive to small business or to any business, or to be punitive toward any of the workers in this country.

What we do want to do is eliminate some of the present practices where we have actually had people before this committee come up and say, "We dumped and it was legal, and that is the way it goes," and they walked away from their liability.

I was infuriated and want to make it positively clear that this is not going to be legal and we are going to do everything we can do to see it does not happen again. Again, this is not PBGC who is paying those premiums; it is you and I who are still having defined benefit plans and are still paying those premium increases.

When I saw that the PBGC initially created the $1 increase, I was skeptical and said, wait a minute; that is a dollar today and it will be 10 times as much tomorrow.

Now we are discussing going from $2.60 to $6. I am very, very concerned that if we do not at least do these minimum amounts of reform to insure that we do close some of the loopholes, that break in the dam may start to expand and you may have a lot more going out. If the recession deepened, I think you could see that expansion.

We did not get into liabilities, and I wish I had, with Mr. Jones. The liabilities were much greater last year than originally anticipated, and the loss was much, much greater. What brought about some of this?

He mentioned the $96 million figure. How do we calculate these things in the outyears? It is very difficult. I do not want to be in the situation where a few years from now we say, "Oh, yes, in September 1982 we had a $333 million liability that needed to be amortized over x number of years."

I personally would say the shorter, the better, so we do not start saying it does not matter because we can amortize it over longer and longer years, recognizing the inconsistency that we tell private plans they have to fund theirs over a longer period of time, or they have a longer period of time.

I do not want us to get into the false sense of security of thinking we can eliminate some of this inequity if we just spread it out over a greater number of years. Also, I do not want to see that increase on a large scale. It is going to be our intention to do everything we can to limit that amount.

I see that as the liability increases, there is greater and greater pressure against the defined benefit industry, and that penalizes, certainly, all companies and all participants. I do not think that is to the economic benefit of those participants, those companies, or to our country as a whole, particularly if you look at the magnitude of the dollars that are involved.

I do not want to be back here next year or the year after looking at larger and larger rate increase requests by the PBGC. We do feel like some reforms need to be made. I am certainly interested in the comment you made that you think a smaller premium increase would be sufficient. I am assuming that you have also looked at GAO's study.

Mr. JACKSON. I have not seen the GAO study.

Senator NICKLES. GAO basically came up with a study that confirmed the need for the increase and substantiated, I believe, the increase to $6.

We are receptive. I appreciate the cooperation of all of our panelists today, and I apologize again for the fact of, by necessity, having to run this hearing as rapidly as we did.

We do appreciate your input for ways and measures that we might be able to tighten up, either statutorily or through report language, some of the good ideas that have been made today.

[Additional material submitted for the record follows:]

Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

JUN 14 1983

Honorable Don Nickles
United States Senate
Washington, D.C. 20510

Re: Hearings on S. 1227

Dear Senator:

It is with regret that I was not able to request your permission to appear in person at the hearing which you held on June 14 regarding S. 1227.

Since my appointment to membership on the Advisory Committee of the Pension Benefit Guaranty Corporation, and particularly since the appointment of the late Lee Hubbard, Chairman of the Advisory Committee, the Advisory Committee has inquired at length into the need for legislation of the kind set forth in S. 1227. We prepared a paper on the subject which is respectfully enclosed for your consideration and, if possible, for inclusion in the record of your hearing.

As you will see from the enclosed report, the Advisory Committee is strongly supportive of the PBGC's request for a $6.00 premium effective for plan years commencing on or after January 1, 1983 and also strongly supports the other major components of the proposed legislation.

If at any time you wish to talk to me about this matter, I would be happy to do so.

Sincerely yours,

Roger F. Martin
Acting Chairman
Advisory Committee

Enclosure

Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

May 2, 1983

THE HONORABLE
Raymond J. Donovan, Secretary of Labor and Chairman, Board of Directors
Donald T. Regan, Secretary of the Treasury and Member of the Board
Malcolm Baldrige, Secretary of Commerce and Member of the Board
Edwin M. Jones, PBGC Executive Director

Gentlemen:

The Advisory Committee of the Pension Benefit Guaranty Corporation is pleased to submit this "Position Paper" setting forth its views on the Administration's proposed single-employer plan legislative changes, which reflects our eight-months' study of the involved issues.

Advisory Committee's Position Paper on the Single-Employer Plan Termination Insurance Program

I. PREAMBLE

The PBGC Advisory Committee consists of seven individuals appointed by the President to advise the Pension Benefit Guaranty Corporation. The Committee members represent key pension constituencies, with two members representing employees, two representing employers, and three representing the general public. PBGC is an insurance company created to guarantee the benefits in more than 100,000 defined-benefit pension plans covering more than 30 million workers and retirees in the U.S.A. One of its goals includes encouraging the continuation of private pension plans.

Congress enacted the Employee Retirement Income Security Act (ERISA) in 1974 to ensure that workers would receive their promised pensions. Through ERISA, Congress created a government insurance company, the PBGC, to guarantee the payment of workers' pensions following the termination of their private pension plans.

The PBGC's statutory mandate establishes the following responsibilities:

-- To encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants.

-- To provide for the timely and uninterrupted payment of pension benefits.

-- To maintain premiums established by the corporation at the lowest level consistent with carrying out its obligations.

The PBGC Board of Directors -- Secretary of Labor Raymond J. Donovan, Chairman; Secretary of the Treasury Donald T. Regan; and Secretary of Commerce Malcolm Baldrige -- as well as the Presidentially appointed Advisory Committee are dedicated to satisfying this Congressional mandate.

This Advisory Committee feels that, given the PBGC's Congressionally mandated goals, those appointed by the Administration must make the insurance corporation work. Likewise, it falls to Congress to give PBGC the tools to continue to carry out its mission.

The PBGC has three sources of funds:

1. premiums from insured plans;
2. plan assets and employer liability recovery; and
3. investment income.

PBGC's investment portfolio has met the standards of good investment performance. Premium income, however, has fallen drastically behind PBGC's mounting claims, due to recent bankruptcies, termination of numerous plans, and inflation.

The last premium increase became effective January 1, 1978, and set the premium to be paid by single-employer plans at the present rate of $2.60 per participant per year. Since that time, inflation (as measured by the consumer price index) has risen more than 50%, and the corporation's accumulated deficit has exceeded $300 million. As a result, the $2.60 is not adequate to sustain the single-employer plan insurance program.

In 1982, after eighteen months of study, PBGC requested a new premium of $6.00 per participant per year for single-employer plans, an increase of $3.40. By law, this change must be approved by the Congress. It should be noted that the premium is not a tax, but rather is akin to "dues paying" or a user fee, because it insures and protects employees of those who pay the premium.

II. THE PBGC'S IMMEDIATE NEEDS

The primary responsibility of the PBGC is to guarantee the pensions of participants in terminating plans. Our study indicates that there are four major areas of immediate concern:

1. PREMIUM INCREASE

We find that $6.00 is the premium needed to amortize the accumulated deficit in about ten years. The mounting claims of the PBGC and recent substantial

bankruptcies, combined with increased inflation and continuing administrative expenses, have created the deficit. We encourage legislation to balance this equation.

2. WAIVERS

The Internal Revenue Service at present works unilaterally in the matter of contribution waivers. The IRS may grant an employer a waiver of contribution to a pension plan, thus creating an additional liability for the PBGC. While at present the IRS consults with PBGC on some waivers, PBGC has no statutory authority to impose terms on the granting of waivers. PBGC needs to be able to impose conditions on contribution waivers to protect the plan and its benefit promises and PBGC guarantees to participants. Provision for some form of collateralization to the plan for the waived amounts would provide fair and equitable treatment for premium payers to the system.

3. TERMINATION PROVISIONS

Current provisions of ERISA allow an employer to elect, on its own volition, to stop funding an underfunded plan in return for a liability to PBGC in the amount of the unfunded guaranteed benefits, up to 30% of the employer's net worth. These provisions allow abuse of the insurance system in situations where an employer has a low net worth relative to the amount of the employer's potential liability to PBGC. Therefore it is recommended the PBGC be required to take over an underfunded plan only under circumstances to be specified by the law, and after satisfactory arrangements are made for payment to the PBGC of 30% of the employer's net worth and the PBGC obtains a right to receive a profits interest designed to pay back to the PBGC, over a period of years, the amount of losses assumed by the PBGC on the plan's termination, if the ongoing company successfully continues in business and earns a profit.

4. CONTINGENT TRANSFEROR LIABILITY

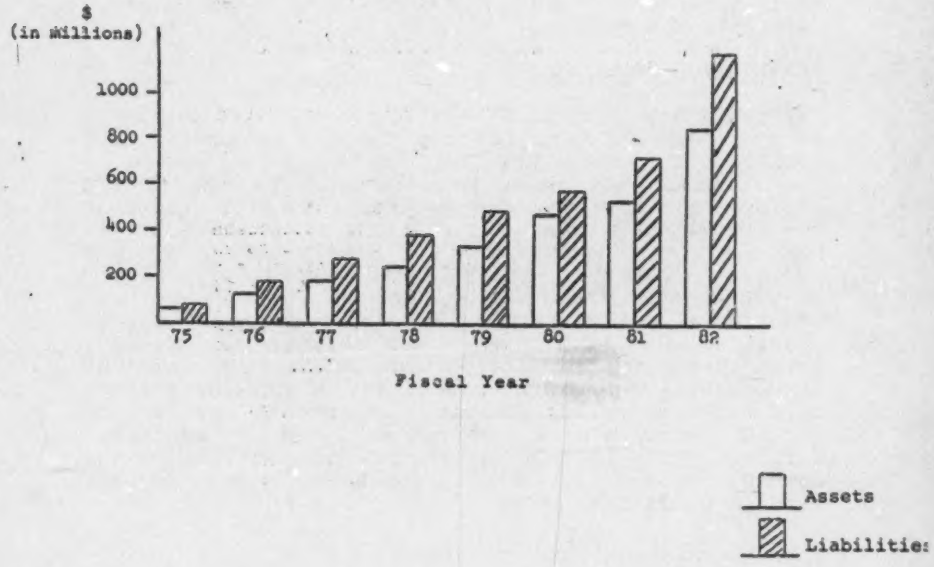
Currently, there is a problem concerning the transfer of underfunded pension liabilities from a stronger company to a weaker company that subsequently fails. Changes are needed to regulate such transfers in the limited number of situations that abuse the insurance system. Standards should be set to require that the buying entity be capable of meeting the pension obligation of the transferred pension plan. Simply put, the PBGC, as an insurance fund, is being victimized by abuses of existing "loopholes."

III. REQUEST TO MEET NEEDS:

Since the last premium increase there have been a mounting number of bankruptcies and plan terminations occasioned by adverse economic conditions. In this unusual environment, PBGC has met its obligations and paid all guaranteed benefits, but losses have been much larger than expected, with the result that the PBGC has incurred a deficit of about $333 million.

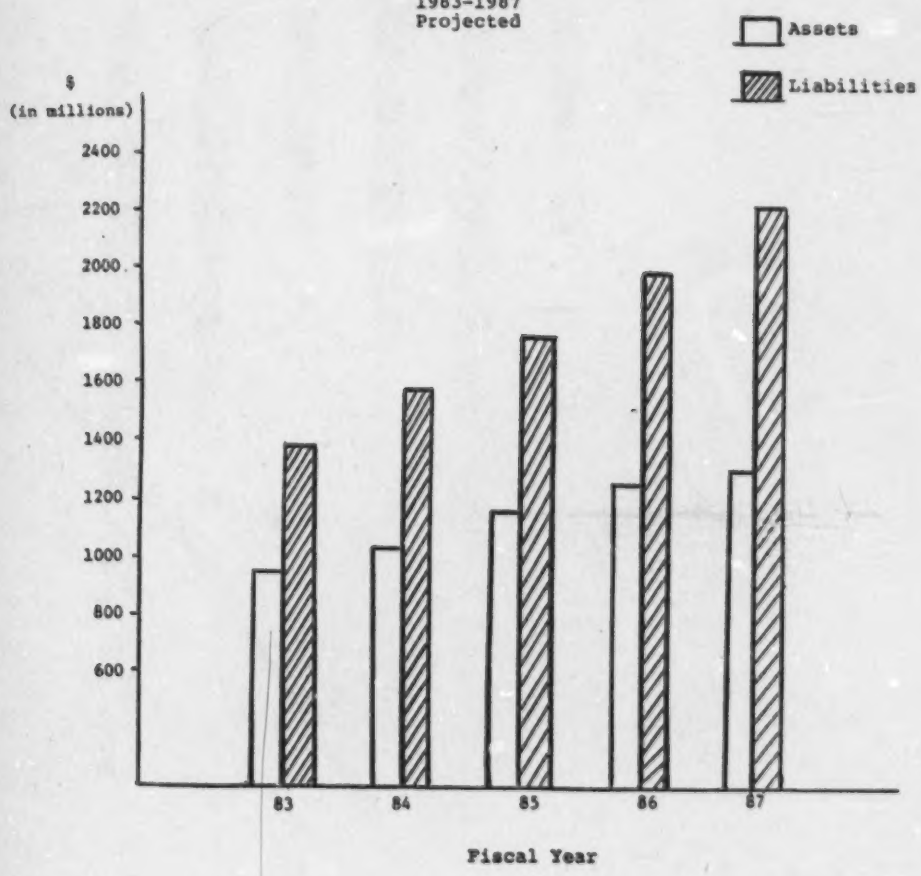
A history of the PBGC in graph form shows how liabilities vs. assets have grown:

CHART ONE
PBGC Single-Employer Program
Assets and Liabilities
by Fiscal Year
1975-1982

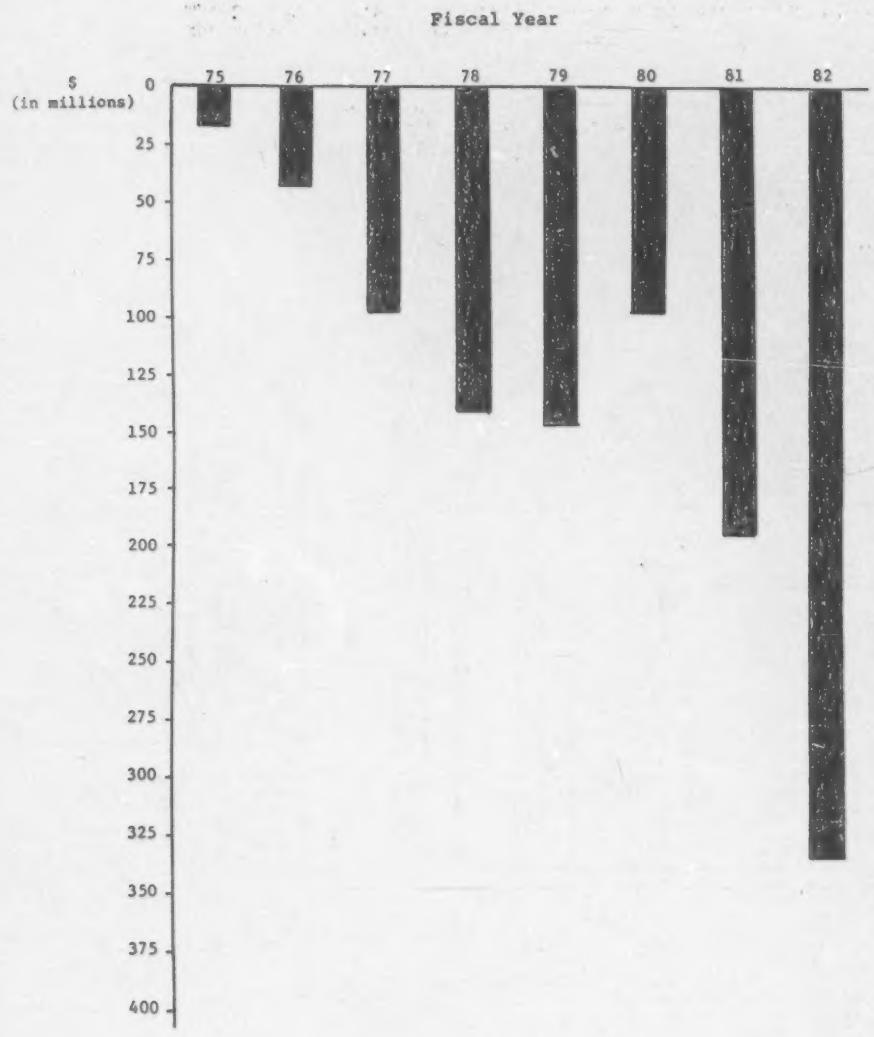


The Corporation's most recent five-year projection indicates the following future trends:

CHART TWO
PBGC Single-Employer Program
Assets and Liabilities
by Fiscal Year
1983-1987
Projected



PBGC Single-Employer Program
Deficits by Fiscal Year
1975-1982



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IV. SUMMARY

Congress in establishing ERISA required that PBGC provide a continuing five-year projection of its ability to meet stated objectives and responsibilities. In conjunction with that request, we have outlined herein where the Corporation has been and where, under normal conditions, it is headed. As a result, it is our unanimous conclusion that:

1. The Corporation is functioning in an adverse financial environment.

2. The Corporation's existing large deficit of $333 million in the single-employer program is not acceptable.

3. Further financial losses on the present premium basis are inevitable and the deficit will increase to levels that will threaten the financial integrity of the program.

4. The requested premium of $6.00 per participant per year will enable the Corporation to meet projected claims or losses of $100 million a year for five years, amortize its existing deficit in about ten years, and meet reasonable administrative costs, thus assuring the more than 30 million participants who are covered by this program that all guaranteed basic pension promises made to them by the private defined benefit pension system shall be fulfilled.

The PBGC's pension guarantee program is an essential part of our country's safety net of economic security. The program serves the invaluable function of reassuring American workers under plans that are terminated, that their pensions, as guaranteed by PBGC, will be paid. That essential purpose should be supported by the financing and safeguards that it requires.

We strongly endorse your and the Administration's position that a $6.00 single-employer premium is needed immediately. Such premium increase will enable the Corporation's insurance program to be self-sustaining. Failure to enact new legislation leads toward an insolvent PBGC insurance program, operating on a pay-as-you-go basis that will fail completely to achieve the goals and purposes established by Congress.

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We believe legislation is needed to increase the premium for this year and to achieve other loophole-closing objectives, so as to make this private part of the American pension system fiscally sound and guaranteed in our time. Under all circumstances, the Congress should finance this program so that the PBGC's existing commitments of $3.3 billion will with certainty be paid to participants on a timely basis.

Respectfully submitted,

Representatives of the General Public:

J. R. Hubbard, Jr.
Lee Hubbard, Chairman,

Roger Martin, member of the committee

Deene Goodlaw Solomon
Deene Goodlaw Solomon, former member and consultant to the Committee

Robert Tilove
Robert Tilove, former member and consultant to the committee

Representatives of Employee Organizations:

Perry Joseph
Perry Joseph, member of the committee

Representative of Employers

Ralph J. Wood
Ralph J. Wood, former member and consultant to the Committee

Statement of the
Machinery and Allied Products Institute
to the
Senate Labor and Human Resources Subcommittee on Labor
on
S. 1227--The Single-Employer Pension Plan
Termination Insurance Improvements Act

June 20, 1983

We appreciate the opportunity afforded by the Senate Labor and Human Resources Subcommittee on Labor to submit written comments on S. 1227, the Single-Employer Pension Plan Termination Insurance Improvements Act. We also applaud the leadership initiative of the Subcommittee Chairman, Senator Nickles, in working towards a solution to a vexing set of problems now being encountered by the Pension Benefit Guaranty Corporation (PBGC).

The Institute's interest in this area is enhanced by the fact that many of its members were pioneers in providing defined pension benefit plans to employees. Indeed, the capital goods and allied product industries have long been committed to making the private pension system a viable and significant contributor to the income needs of the retired segment of our society.

In large part because of this very leadership role--particularly in the early adoption of defined benefit plans before ERISA was even a gleam in the eye of Congress--our members find themselves in the paradoxical position of being forced to contribute a lion's share of the bail-out monies going to fulfill the pension promises of the unsuccessful companies that comprise the list of clients for PBGC. This unenviable position is a central reason why the Institute has such a keen interest in the legislation before the Subcommittee.

An Overview

The goal of S. 1227 is to improve the single-employer pension plan termination insurance program. To achieve this objective, the bill would provide PBGC with a substantial premium rate increase and new authority to deal with the so-called "dumping" problem. The bill also provides that PBGC submit reports to the Congress within 2 years of enactment that identify (1) alternatives for performing some or all of PBGC's functions through private insurers and (2) alternative premium rates and bases that are derived in whole or in part from risks insured by PBGC.

We recognize that a premium increase is necessary to improve the financial stability of the insurance program and that steps must be taken to cut down the dumping of pension liabilities on the PBGC. Agreeing in principle with the general direction of S. 1227, we find ourselves, however, at odds with a number of the specifics of that measure. First, we are not convinced that it is necessary to impose a 130 percent increase in the

per-employee head tax used to fund this program. Second, we think it imperative to undertake--and to complete as rapidly as possible--a study of a variable rate premium. Third, we believe there are issues, largely technical, that must be addressed in the anti-dumping provisions of the bill. Our detailed views follow.

Premium Rate

The underpinning for the proposed $6.00 premium, i.e., the $3.40 increase, seems to be a shifting target. Last year we were told of a growing deficit in the PBGC fund for fiscal year 1982, and the possibility of an equally sizable deficit in fiscal year 1983. In testimony before this Committee on June 14, 1983, however, Mr. Jones, the Executive Director of PBGC, indicated the 1983 experience was much different than was projected. To us such testimony points up a dilemma facing Congress. The officials managing PBGC will--and should--proceed on a prudent path. In projecting financial needs PBGC must at least consider "worst case" scenarios. This means that any "risk taking" assumed in an attempt to minimize the burden of the head tax increase must be borne by Congress. The dilemma is that PBGC officials also serve in the capacity of expert witnesses on the issue.

In our view, this Subcommittee will have to rely in significant measure on common sense. The economy has clearly been battered; the number of business failures in 1981-82 was at record levels. Yet, since the end of fiscal 1982, the scene has markedly shifted. There have been significant gains in stock market prices and hence in the market value of pension plan assets; interest rates have moderated; and economic recovery in certain areas is clearly visible, if not already here. This kind of economic climate may well dictate less urgency to rapidly move to a very high premium rate.

We do not, of course, have sufficient information available to technically challenge the PBGC's proposal. We are encouraged, however, that in the year since the $6.00 rate was first proposed and the Subcommittee's recent hearings, PBGC's own estimate of the administrative costs of the insurance program evidently has dropped from $1.00 per covered employee to $.85. Hopefully, those costs can be lowered still more.

In brief, we recommend that Congress consider raising the premium rate to something less than $6.00. In this regard, we respect the expertise of Paul H. Jackson, Vice President, The Wyatt Co., and spokesman for the National Small Business Association, who stated at the Subcommittee's June 14, 1983 hearing: "A $3.50 premium should be sufficient."

As to timing, we think that it would be appropriate to make the premium increase effective as of January 1, 1984. We frankly are not convinced that a delay of one year from the proposed January 1, 1983 increase would necessitate an $8.00 rate for 1984. It seems evident that such a jump is premised on a scenario of economic disaster and we think that to be highly unlikely.

Study of a Variable Premium

It appears to be the basic premise of PBGC that a $6.00 per-participant premium--and we recommend something less than that--will not be adequate to fund the termination insurance program for very long. Beyond this concern, the flat-rate premium is by definition inequitable for employers of well-funded plans. These employers are being penalized by paying for risks they did not create. As the Administration's task force which helped develop many of the provisions of S. 1227 has pointed out, ". . . each rate hike will further discourage the formation of new defined benefit plans, and give the best funded plans a larger incentive to terminate. . . ." It therefore appears imperative to us that a full-blown study encompassing feasibility of a variable rate premium be instituted as soon as possible. We would hope that such a study could be completed within a year, even though we acknowledge that this is a complicated assignment.

In this connection, we also recommend that the study group include experts outside of government. This we feel is important because the starting point for such a study is a hard look at the assumptions and methodology upon which the PBGC premium is calculated to determine the amount of premiums payable in the future.

Preventing "Dumping"

S. 1227's approach to the "dumping" problem can be summarized as follows:

-- PBGC would be authorized to place conditions on funding waivers sponsors are granted by the IRS in order to improve insurance program recovery prospects should the plans be terminated;

-- Ongoing sponsors would be prohibited from terminating insufficient plans unless the sponsor shows PBGC that it could be forced out of business if it continued plan contributions and PBGC obtains assurance that it will collect the insufficiency from the sponsor; and

-- A ten-year contingent liability would be established for certain sponsors divesting portions of their business with underfunded pension plans that later terminate.

To one degree or another, each of these provisions creates some problems for companies not trying to "dump" their pension liabilities on PBGC. To explain more fully:

Funding waivers.--PBGC would be given a statutory role to play with regard to IRS waivers of the employer's employee payments of minimum plan contributions during periods of business hardship. Depending on how

restrictive the PBGC terms are, this approach could make it more difficult for the employer to get credit. Another concern is that the lien given PBGC may force some employers into bankruptcy as contrasted with using the hardship waiver process.

Termination of insufficient plans.--S. 1227 would continue present law for adequately funded plans and allow employers to terminate or freeze those plans at any time. However, an employer would be permitted to terminate an insufficiently funded plan only if it proved to PBGC that termination was a financial necessity for the company to continue in business. The hardship tests appear overly stringent and clearly could cause unintended problems.

Ten-year contingent liability.--S. 1227 would amend ERISA to provide a contingent liability extending over ten years following business transfers by a plan sponsor or controlling business entity when unfunded guaranteed benefits of $500,000 or more exist at the time of the transfer. There are likely to be several problems. First, 10 years is too long. Second, not every transfer creates a risk of loss. Finally, there are no safeguards to reflect reduction of liability on the part of the acquiring company followed by a later business reversal recreating the liability.

In short, on these three provisions we see the need for a clearer statement of PBGC authority--some additional standards perhaps--and some changes to make these provisions less harsh.

Concluding Comment

The Institute appreciates this opportunity to present its views. We agree wholeheartedly that the issue of appropriate (i.e., amount and type) PBGC premiums must be studied and resolved promptly. We agree too that efforts should be made to limit whatever "dumping" has occurred in the past. We hope, however, that in working toward a solution that the Subcommittee will bear in mind that steep increases in the premium are likely to bring about considerable negative and unwanted impacts. We think it fair to add also that the alleged instances of dumping are relatively few in number and urge the Subcommittee to avoid legislative overkill in moving to correct the law in this area.

THE Wyatt COMPANY

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June 16, 1983

The Honorable Donald L. Nickles
United States Senate
Room 713
Hart Senate Office Building
Washington, D.C. 20510

Re: S.1227

Dear Senator Nickles:

At your Senate Labor Subcommittee hearing yesterday on S.1227, you asked me whether the $500,000 exemption included in the bill for transferor liability would not largely eliminate the problems which might be created for small business. Since I was appearing as a witness on behalf of the National Small Business Association, my answer was expressed in terms which I felt they would surely support. I did wish to write you, however, setting out my own personal views on this matter which I believe is a most important one.

The PBGC is faced with a relatively minor problem of abuse in the case of transferred pension plans -- a problem that may account for something on the order of 5% of their claim liability. Based on past experience, roughly one plan a year can be expected to be transferred in an attempt to dump liability on the PBGC, and those actions may be expected to impose $5 to $10 million of liability. To curb that abuse, PBGC proposes the imposition of contingent liability in the case of every sale, subject to the right of the plan sponsor who is transferring to demonstrate to PBGC through one of a number of different "safe harbors" that the liability need not be imposed. There are probably 4,000 or 5,000 such transfers a year involving pension liability and, as a general matter, it seems unreasonable to me to force 4,000 or 5,000 sellers through an entire new list of procedures and filings with PBGC in order to avoid the liability imposed by one dumping employer.

My own business career extends back to 1949. At that time, all of the rules relating to group life insurance could be incorporated in a five-page memo. All of the rules relating to

group health insurance could be covered in a one-page memo. All of the law, regulations and revenue rulings pertaining to pension plans could be covered by a 40- or 50-page book. Since that time, year by year, Congress and the administrative agencies have added literally tens of thousands of pages of laws, regulations, interpretations, etc., in the group insurance and pension area. The process has been very similar to varnishing furniture. Almost nothing is added with each new application, but after awhile a thick coating has built up. Similarly, no one set of regulations or procedures, in and of itself, appears to be unreasonably onerous. Adding them all together, however, they now constitute a totally unreasonable burden on commerce. America finds itself, largely as a result of this process, unable to compete in world markets.

President Derek Bok of Harvard University presented the Board of Overseers earlier this year with a report covering the state of the legal profession in the U.S. President Bok is a distinguished scholar, an experienced lawyer, and a fairly impartial observer of the legal scene. While he focused chiefly on litigation, one of the points emphasized was that by concentrating so intently on the problem faced by one specific group, the solutions found might thereby impose intrinsic burdens almost unnoticed on the rest of society, but when taken as a whole, the end result might not be worth it. I am not a lawyer by training, but I read President Bok's report very carefully and I believe many of his observations and criticisms are valid. I am enclosing a copy of his report for your review, thinking that you too might find it of interest.

As you may have heard, there is a trend beginning to develop in our country of major companies terminating their well-funded defined benefit pension plans and replacing them with defined contribution programs. If legislation should put the sponsor of a defined benefit pension plan in a position where there are potential liabilities following the sale of the business which would not exist if there had been a defined contribution plan, surely in the long run this must serve as an additional incentive to abandon defined benefit pension plans. Since the PBGC receives its premium income only from the sponsors of such defined benefit plans, any such trend would have the ultimate effect of eroding their premium base and requiring further contribution increases to support a given level of obligation.

Statistical data developed by PBGC suggests that about $7,000,000 each year in liabilities (about 25¢ per plan participant) could be avoided if S.1227 were to pass, by reason of the contingent liability that would be recovered after transfers. This is a rather misleading figure, however. PBGC is assuming that by recovering the $7,000,000 from a predecessor employer, all else will remain unchanged -- and this is simply not the case. For example, the case of Wisconsin Steel, which was spun off by International Harvester, was cited by PBGC as a

classic example of a rich parent divesting itself of pension liabilities for a subsidiary and dumping them on the PBGC. If the PBGC had gone back to International Harvester, however, with a claim against Harvester's assets for the Wisconsin Steel liability, that very act might well have meant that International Harvester could not obtain credit and might have been forced to fold, thus adding the unfunded liability of the Harvester plans to the PBGC's claims. The collapse of a company as large as International Harvester would probably offset 20 or 30 Wisconsin Steels. In short, when second order effects are considered, the imposition of transferor liability could actually increase PBGC's total claims rather than decrease them.

On balance, you and your associates in the Senate and House must decide whether the added burdens on 5,000 business transactions is a fair price to pay for a possible 25¢ reduction in the annual PBGC premium. If the PBGC is unable to prove in court that even one sale each year was undertaken with a principal purpose of evading or avoiding liability, then perhaps Congress should not base legislation on the assumption that all 5,000 sales that year might be mere shams to avoid pension liability. At the very least we might first try imposing contingent liability only where a principal purpose of the transfer is to evade or avoid liability. Another layer of varnish should be avoided if at all possible.

Sincerely,

Paul H. Jackson

Paul H. Jackson
Vice President

PHJ:cd

Enclosure

STATEMENT SUBMITTED BY
THE AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS
TO THE LABOR SUBCOMMITTEE OF THE SENATE LABOR AND HUMAN
RESOURCES COMMITTEE ON S. 1227, THE SINGLE-EMPLOYER PENSION PLAN
TERMINATION INSURANCE IMPROVEMENTS ACT OF 1983

June 23, 1983

The AFL-CIO is concerned with the problems which have developed under the single employer pension plan termination insurance program, and hopes that satisfactory legislation to resolve them will soon be forthcoming. We appreciate the opportunity to present our views on S. 1227, and to make suggestions for dealing with some of these problems.

Premium Increase

The PBGC is financed by mandatory insurance premiums. For the single employer termination insurance program, the annual premium is currently $2.60 per participant. The long term liabilities of the PBGC -- mostly pension benefits due workers in the future -- currently exceed its assets by about $333 million. In order to eliminate this deficit, S. 1227 would increase the annual premium to $6.00 per participant. We believe that prompt action to deal with the PBGC's deficit by raising the premiums is imperative, and we therefore strongly support this provision of the bill.

"Dumping" Pension Liabilities

Under present law, if a pension plan terminates without enough assets to pay all benefits guaranteed under ERISA, the PBGC becomes responsible for paying those guaranteed benefits.

The PBGC in turn has a claim against the control group for the difference between the plan's assets and the guaranteed benefits, but only up to 30 percent of the control group's net worth. Thus, in situations where the unfunded guaranteed benefits in a pension plan exceed 30 percent of the control group's net worth, the plan sponsor has an incentive to terminate the plan in order to dump its pension obligations onto the PBGC. This loophole allows solvent employers to pass the cost of promised pension benefits onto the PBGC, and ultimately onto other premium payers.

In addition, under present law the PBGC does not guarantee certain vested benefits, such as early retirement supplements or benefit increases instituted within the last five years. Accordingly, if a plan terminates without enough assets to pay for the non-guaranteed vested benefits, the participants wind up losing those benefits. In these situations, the plan sponsor has an additional incentive to terminate its pension plan in order to evade responsibility for the non-guaranteed vested benefits.

Under the approach embodied in S. 1227, if a pension plan does not have sufficient assets to pay for all guaranteed benefits, the plan sponsor generally would not be permitted to terminate the plan, except in certain extreme hardship situations. However, if the plan was sufficiently funded to pay all guaranteed benefits, the plan sponsor would still be permitted to terminate the plan at any time, even though there might still be a loss of non-guaranteed vested benefits.

We believe that the foregoing approach simply addresses the concerns of the PBGC, not participants. We suggest an alternative approach that would both preserve the voluntary nature of the private pension system, and at the same time better protect the earned pension rights of American workers.

Freeze of Accruals

Under this alternative approach, plan sponsors should be permitted to freeze the accrual of pension benefits in accordance with procedures currently in effect under Title IV, subject of course, to any contractual or other limitations arising under collective bargaining agreements. The plan sponsor, would still be required to continue funding the pension plan, and the PBGC phase in clock would still continue to run. Most importantly, the plan sponsor and control group would still be responsible for paying all accrued benefits, including those benefits which were not yet vested at the time the plan was frozen.

Plan Termination

Employers should also be permitted to terminate their pension plans, again subject to any collective bargaining limitations. However, additional protections should be incorporated into Title IV to protect both the PBGC and participants, and to prevent solvent employers from evading their responsibility for promised benefits.

When a plan is terminated with insufficient assets to pay for all guaranteed benefits, the control group should

continue to be liable to the PBGC for the difference between guaranteed benefits and plan assets, up to 30 percent of the control group's net worth. In addition, the control group should be required to pay any remaining shortfall out of future profits. For example, the PBGC could be given an additional claim for a percentage of the control group's pre-tax profits for a specified period of time.

Notwithstanding the termination of a plan, the control group should also continue to be liable for any non-guaranteed vested benefits (including those benefits which become vested upon termination). This obligation, which could be on a pay as you go basis, would continue until liquidation of the control group.

The AFL-CIO submits that this approach is only fair. It would still allow employers the flexibility to terminate their pension plans. At the same time, it would prevent solvent employers who can afford to fund their plans from dumping their pension liabilities onto the PBGC and participants.

Contingent Liability

Another important problem with the present single employer termination insurance program concerns the status of pension liabilities in situations where there has been a sale, spinoff, division or other business transaction involving the plan sponsor. If a pension plan is terminated shortly after a business has been sold, the sellers can escape any obligation to the PBGC or participants, even though they were the plan sponsor during

the period when the liabilities were accrued. Because of this loophole, some employers have sold or spun off weak subsidiaries so as to insulate the parent company's assets from the PBGC's claims when the subsidiaries subsequently terminated the pension plan. S. 1227 deals with this problem by providing for contingent liability for a specified number of years when a business is sold or when an employer leaves a control group. The AFL-CIO strongly endorses this concept, since it would effectively prevent employers from avoiding liability for pension benefits through a sale, spinoff, division or other business transaction.

It is equally important to expand the responsibility of other employers within the same control group to participants and to the PBGC. Since 50 percent ownership normally constitutes control, we believe that the use of a 50 percent test for determining control group liability, as provided for in S. 1227, is appropriate.

Funding Waivers

Under present law, the Internal Revenue Service (IRS) may waive all or part of a plan's annual minimum funding obligation and instead require that the waived amount be amortized over 15 years. We support the provision in S. 1227 which would require that, whenever a funding waiver is granted, a lien shall arise on behalf of the plan for 100 percent of the waived amount. We also believe a plan sponsor should be required to inform any labor union representing plan participants whenever it requests a funding waiver.

Extraneous Amendments

Though the AFL-CIO supports amending the single employer termination insurance provisions of ERISA, we are concerned about ill-advised attempts to attach extraneous amendments to this legislation as it goes through Congress. We are particularly concerned about amendments to the multiemployer termination insurance program.

The multiemployer termination insurance legislation of 1980 made sweeping changes in this program. Time is required for rational implementation of this complex legislation. The statute provides sufficient flexibility to make any necessary adjustments through regulation. Considerable progress in administering the new law has been made and the remaining problems can be handled by regulations.

Amendments to the law at this time could disrupt the understanding, acceptance, and adjustment made by the many groups concerned with the multiemployer termination insurance program. In addition, hasty action on amendments changing such a complex law will only endanger the progress and stability that has been achieved and hamper further progress.

For these reasons, the AFL-CIO will oppose the passage of pension legislation if it includes amendments to the multi-employer termination insurance program.

PRESIDENT
Bennett C. Whitlock, Jr.
(202) 797-5212

AMERICAN
TRUCKING
ASSOCIATIONS, INC.
1616 P Street, N.W., Washington, D. C. 20036

The Honorable Don Nickles
Chairman
Subcommittee on Labor
Senate Committee on Labor
and Human Resources
Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

The American Trucking Associations, Inc. (ATA) is the national trade association of the trucking industry, a federation of associations in all 50 states and the District of Columbia, representing all types and kinds of regulated motor carriers as well as private fleets. Many trucking companies contribute to both multiemployer plans and single-employer pension plans. Therefore, ATA is vitally interested in the "Single-Employer Pension Plan Termination Insurance Improvement Act of 1983" (S. 1227).

As you know, ATA vigorously opposed S. 1541 in the last Congress. S. 1227 represents a significant improvement in several areas over S. 1541. Nevertheless, certain provisions of S. 1227 interfere unduly with the normal conduct of business by employers that maintain single-employer plans. We have identified three such areas and discuss each of them in detail in the enclosed statement. These three areas are:

1. Expansion of controlled group definition for both single-employer and multiemployer plan liability.

2. Contingent liability.

3. Minimum funding waivers.

We share your hope that the single-employer plan insurance program can be improved. However, we urge you, in addressing potential abuses of current law, to remember that

thousands of transactions take place each year with no intent (or effect) of dumping pension liabilities on the PBGC. Undue interference with normal business transactions can only lead to fewer and fewer defined benefit plans, to the eventual detriment of both retirees and workers.

Respectfully submitted,

Bennett C Whitlock Jr

Bennett C. Whitlock, Jr.

BCW/ke

SUBCOMMITTEE ON LABOR
SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES
S. 1227

The American Trucking Associations, Inc. (ATA) is the national trade association of the trucking industry, a federation of associations in all 50 states and the District of Columbia representing all types and kinds of regulated motor carriers as well as private fleets. Many trucking companies contribute to both multiemployer plans and single-employer pension plans. Therefore, ATA is vitally interested in the "Single-Employer Pension Plan Termination Insurance Improvement Act of 1983" (S. 1227).

As you know, ATA vigorously opposed S. 1541 in the last Congress because it would have "improved" the single-employer termination insurance program at the expense of normal business transactions. S. 1227 represents a significant improvement in several areas. The bill retains the current 30 percent of net worth limit for employers who are going out of business; contingent liability has been eliminated where the unfunded pension liabilities transferred are less than $500,000; and termination has been retained as the insurable event.

Certain provisions of S.1227 which are ostensibly designed to prevent potential abuses of the insurance system interfere unduly with the normal conduct of business by employers that maintain single-employer plans. We have identified three such areas and will discuss each of them in detail.

1. Expansion of controlled group definition for both single-employer and multiemployer plan liability. S. 1227 would amend the definition of a controlled group in two ways. For single-employer plans, the bill would lower the percentage needed for common control from 80 percent to a "more than 50 percent" test. For both single-employer and multiemployer plans, the bill would delete the requirement that the controlled group regulations under Title IV of ERISA be "consistent and coextensive" with the controlled group regulations under the Internal Revenue Code. This change has the effect of deleting the 80 percent test for common control for multiemployer plans. This result appears unintended since it is not mentioned in the summary of the bill.

Even if the 80 percent test were restored, the second amendment would leave the Pension Benefit Guaranty Corporation (PBGC) free to draft completely new controlled group rules, without any guidance from Congress and without any showing that the current definition of a controlled group has led to abuses. For example, PBGC's regulations could expand the family

attribution rules or the definition of control for brother-sister groups. In addition, PBGC might define "trade or business" to include passive investment vehicles such as real estate partnerships, which are currently not considered "trades or businesses" and which may be unrelated to the business maintaining the plan. The definition of controlled group already extends liability beyond the normal definition of employer. Additional extension of liability could disrupt existing business relationships and put at risk the equity owned by other shareholders outside the controlled group.

The definition of a controlled group is critical in determining what related entities are liable if a company terminates its single-employer plan or withdraws from a multiemployer plan. In addition, the size of the controlled group could determine the amount of the liability, since PBGC's claim would still be limited to 30 percent of the employer's (i.e., controlled group's) net worth for certain purposes under the bill. For multiemployer plans, the make-up of the controlled group can affect both the amount of liability (e.g., if the employer liquidates) and whether a withdrawal has in fact occurred (if other members of the same group perform work in the same industry or in the same plan).

Expansion of the controlled group definition for Title IV also creates some technical problems, as currently drafted. Section 404(g)(2) of the Internal Revenue Code permits deductions for payments of employer liability to PBGC or to a multiemployer plan if made by "a member of a commonly controlled group of corporations, trades or businesses within the meaning of subsection (b) or (c) of Section 414." Expansion of the definition of controlled group raises the possibility that a business outside the current definition could be liable for a withdrawal or a plan termination but could not deduct liability payments when made.

2. Contingent liability. Although improved, the contingent liability provisions still raise significant concerns. While some employers have sought to "dump" pension liabilities by selling unprofitable divisions or subsidiaries, these are rare exceptions. Most sales are arranged for reasons totally unrelated to pension liabilities. Experience with the sale of assets provisions of the Multiemployer Pension Plan Amendments Act of 1980 has shown that contingent liability leads to uncertainty in negotiating and finalizing sales of operating assets. The bill goes further than the Multiemployer Act by imposing contingent liability for ten years, an unreasonably long period to hold a seller liable for a pension plan that is outside his control. If some period of contingent liability is

necessary, it should not exceed the five years currently required under the multiemployer rules for sales of assets (ERISA §4204). The contingent liability provisions are also overly broad in attaching liability to entities whose only tie to a plan is the fact that they were once within the same controlled group as the employer maintaining the plan. For large employers with frequent acquisitions and divestitures, this provision could create a web of unrelated entities that would eventually be liable.

The Administration claims that 93 percent of all transfers will not give rise to contingent liability because of the exemptions for small transfers (less than $500,000 in unfunded pension liabilities) and for other transactions which the PBGC will exempt in regulations. However, the contingent liability provisions of S. 1227 provide no mechanism for exemption of non-abusive transactions while regulations are being drafted. This omission will create additional uncertainty and costs for employers that transfer pension liabilities in the interim (or for buyers who purchase portions of a controlled group that may have contingent liability). Similar regulations under the 1980 Multiemployer Act took over two years to propose and are not yet final.

In order to arrive at the 93 percent figure, the PBGC must already know some of the transactions that should not give

rise to contingent liability. We assume that these would include sales to purchasers whose net assets or net income equal or exceed those of the seller and sales where the controlled group maintaining the plan receives fair market value for a transferred member. These transactions should be included in the bill as specific exemptions, with authority to the PBGC to prescribe additional exemptions either through regulations or through individual proceedings.

3. Minimum funding waivers. The bill would permit the PBGC to impose conditions on any funding waiver granted by the Internal Revenue Service (IRS) and, in addition, would impose a tax lien on all of the employer's property if a waiver were granted. Under current law, which would be unchanged by the bill, the IRS grants funding waivers only on a showing of business hardship and likelihood that the waived amount would be repaid in the future. A broad lien on the employer's property when the employer is already undergoing significant business hardship would hinder an employer's ability to obtain credit at a time when such credit can make the difference between continued operation and bankruptcy. Lenders would be unwilling to advance additional funds to the employer, since the employer would have no unencumbered property to offer as security. The creation of the lien would also undoubtedly constitute an event of default,

jeopardizing pre-existing loan agreements, as is currently the case with tax liens and the PBGC's lien for employer liability. Therefore, we urge that the bill create no lien when an employer obtains a funding waiver; any claim for the waived amount should remain an unsecured claim.

For composite single-employer plans, the bill would allocate liability on the basis of the employer's required contribution for the year in which the waiver is granted. Liability should be allocated on the basis of average contributions over a longer periof of time, such as five years.

In addition, as the bill is currently drafted, the new funding waiver rules would apply to multiemployer plans. We understand from the PBGC that this is an inadvertent drafting error that will be corrected.

CONCLUSION

We appreciate this opportunity to address this important matter. We share your hope that the single-employer plan insurance program can be improved. However, we urge you, in addressing potential abuses of current law, to remember that thousands of transactions take place each year with no intent (or effect) of dumping pension liabilities on the PBGC. Undue interference with normal business transactions can only lead to fewer and fewer defined benefit plans, to the eventual detriment of both retirees and workers.

STATEMENT OF
INTERSTATE CARRIERS CONFERENCE

BEFORE THE

SUBCOMMITTEE ON LABOR
COMMITTEE ON LABOR AND HUMAN RESOURCES
UNITED STATES SENTATE

ON

S. 1227

SINGLE-EMPLOYER PENSION PLAN TERMINATION
INSURANCE IMPROVEMENTS ACT OF 1983

July 5, 1983

The Interstate Carriers Conference*, an affiliate of the American Trucking Associations--whose statement on S. 1227 we endorse--is composed of approximately 800 trucking companies operating throughout the United States. Carrier members range in size from those with only a few units of equipment to companies operating 500 or more vehicles. The Conference is composed of carriers equally varied in terms of their operating revenues, with approximately 31 percent of the membership having gross revenues of less than $1,000,000. These carriers are predominantly closely held corporations, many of them family-owned, and thus have a critical interest in the proposals in S. 1227.

This statement is divided into three sections containing, respectively, our comments concerning the general concept behind S. 1227, our comments on certain key provisions in the bill, and our comments on miscellaneous technical aspects of the bill.

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* Established on July 1, 1983, upon merger of the Common Carrier Conference-Irregular Route and the Contract Carrier Conference.

IN GENERAL

While, as taxpayers, we share the general concern over the deficit of the Pension Benefit Guaranty Corporation, we believe that the Congress should not lose sight of the PBGC's function. The PBGC is an insurer, and the essence of insurance is the transfer of risk in consideration for payment by the insured. 1/ We question whether the effect of this bill, and particularly the provisions expanding the definition of a controlled group and establishing contingent liability, will not be to insulate the PBGC against risk to a far greater extent than is necessary either to put the PBGC on a sound financial footing or consistent with the normal business operations of those maintaining single-employer plans.

No doubt many private insurers would be delighted to be able to recover from their insured, if events occurring as long as ten years after the happening of the insured loss turned out to be other than had been originally expected. We recognize that even a private insurer is entitled to provide in its insurance contract that it will have recourse against the insured if the insured takes action fundamentally inconsistent with the basis on which the insurance contract was entered into. However, by failing to limit its provisions to abuse situations and by making an employer responsible (through its contingent liability provisions) for the acts of another person over whom the employer has no control, the bill departs substantially from the insurance concept.

1/ We do not address the issue of whether it is a proper role of government to be involved in the insurance business. However, we welcome Section 10 of the bill, which requires a feasibility study of privatization, and Section 11, which apparently recognizes that the PBGC is an insurer.

KEY PROVISIONS

A. Expansion Of Control Group Definition

For single-employer plans, S. 1227 expands the definition of a control group from cases where there is 80 percent control to a situation where common control exists only to the extent of more than 50 percent. 2/ This change in existing law causes us concern for two reasons. First, we are not aware of any evidence that abuses have occurred in the case of controlled groups where the common control has been in the range of 51 to 79 percent. Nor is there any evidence of which we are aware that this change would assist in reducing the PBGC deficit. Of course, the PBGC's deficit could be reduced even further if the common control requirement were set as low as 1 percent. Our point, however, is that any change in existing law, particularly to a well-established provision on the basis of which many corporations with common ownership have structured their affairs, should be based upon something more substantial than the mere hope that casting the net wider will produce a greater catch.

Second, the deletion of the requirement that the PBGC's regulations be "consistent and coextensive with" the Internal Revenue Service's regula-

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2/ The bill's deletion of the last sentence of Section 4001(c)(1) of ERISA, which tied the TItle IV definition of commonly controlled trades or businesses to the IRC Section 414(c) definition and thus imported an 80 percent requirement, may have the effect of reducing the 80 percent control requirement for multi-employer plans. Whether it has this effect will depend upon the PBGC's regulations. We assume this change to existing law was unintended, because it is not mentioned in the summary of the bill and the last phrase of Section 4001(a)(14) of ERISA, as amended by the bill ("expect that 'common control' shall be based on a common interest of more than 50 percent"), appears to suggest that the 80 percent control requirement is intended to continue for multi-employer plans.

tions (a change that applies to both single-employer and multi-employer plans) gives the PBGC, in our view, too wide a latitude and introduces an undesirable element of uncertainty into the law. This area has been sufficiently uncertain (and has only recently been clarified by the Supreme Court in its Vogel Fertilizer decision) to make it, in our view, undesirable to give yet another agency free rein to define a controlled group of corporations, trades or businesses for its own purposes.

It must be emphasized, moreover, that the question is more than one merely of definition, because the definition determines both who will be liable under Title IV and the extent of that liability. Finally, we note that the unlinking of the Internal Revenue Code and ERISA definitions of a controlled group could result in the imposition of liability upon an employer while denying that employer the benefit of a deduction when he satisfies the liability. 3/

B. Contingent Liability

Although we accept that some employers have sought to rid themselves of pension liabilities by selling divisions or subsidiaries, we believe these cases are few. Certainly, we are not aware of any evidence suggesting that such circumvention represents the norm. Against this background, we believe the contingent liability provisions of S. 1227 are excessivley broad, both in transactions they reach and in the length of time during which contingent liability may exist. As to the latter, we believe that there is no good reason for extending the period of contigent liability

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3/ See IRC Section 404(g)(2) permitting a deduction for payments of employer liability to the PBGC or a multi-employer plan "if the employer is a member of a commonly controlled group of corporations, trades, or businesses within the meaning of subsection (b) or (c) of Section 414."

beyond the five years currently provided for under the multi-employer rules for sales of assets (ERISA Section 4204).

As to whether there should be contingent liability at all, it is our view that such liability should be the exception rather than the rule. If the avoidance of employer liability is a common practice--and, as previously mentioned, we are not aware of any evidence to that effect--then it should be possible to identify those transactions by means of which such liability is avoided. Instead, the bill adopts the approach that all changes in benefit obligations give rise to contingent liability unless the provisions of Section 4064A(e) of ERISA, as amended by S. 1227, apply.

If this presumption in favor of contingent liability is to be retained in the bill, we would like to see an additional provision permitting an advance determination by the PBGC, upon application by an employer, that there has been no increase in the risk of loss to the PBGC. As now drafted, the bill gives the PBGC authority to promulgate regulations in this regard but does not require it to provide for binding determinations within a specified time after the change in benefit obligations. It is only by specifically including such a provision that the business uncertainties caused by the existence of contingent liability can be avoided.

In addition, we believe that the imposition of liability upon entities whose only connection with a plan is that they were within the same control group as the employer maintaining the plan is excessivley broad. Once again, the bill casts its net wide in the hope of catching as many employers as possible in order to protect the PBGC. In so doing, however, it disregards elementary principles of fairness and would cause business uncertainty.

For example, the purchaser of a company may now have to examine the records of affiliates of that company over a period extending as far back as ten years in order to ensure that the corporation, which may never have maintained any kind of pension plan, is not contingently liable for the acts of a transferee of its affiliate. Our comments in this regard apply a fortiori if the expansion of the control group definition is retained in the bill and the ten-year period for contingent liability is not reduced.

C. Minimum Funding Waivers

Under S. 1227, a lien arises automatically in favor of any plan that obtains a waiver of the minimum funding standards. We believe this provision to be both unnecessary and excessive. By definition, an employer obtaining a waiver of the minimum funding standard is one that is already suffering business hardship. To impose upon such an employer an automatic lien on all of its property will obviously hinder its ability to obtain credit at precisely the time when it is most likely to need credit. We believe it disregards the economic realities of such an employer to impose an automatic lien on all of its property.

At the very least, the PBGC should have discretion to waive the lien in particular cases or to restrict its application to less than all of the property of the employer. Because Section 4010(a)(1) of ERISA, as amended by the bill, empowers the PBGC to condition the waiver of the minimum funding standard on obtaining security in favor of the plan, we believe that Section 4010(a)(2), imposing the automatic lien on all the employer's property, is unnecessary and should be deleted from S. 1227.

TECHNICAL COMMENTS

(a) Should the reference to "loan value" in Section 4010(a)(4) of ERISA, as amended by the bill, be a reference to "lien value"?

(b) Is the reference in the second line of Section 4010(b), as amended by the bill, to paragraph (1) intended? No lien arises under paragraph (1).

(c) Section 4064(a)(1) of ERISA, as amended by the bill, contains the phrase "before the end of the tenth year following the date on which the change occurred." This should be clarified. Is the reference intended to be to a plan year or a calendar year, or is the reference to a 120-month period? If so, the use of this phrase would be clearer.

(d) With respect to Section 4064(b)(1), as amended by the bill, is there contingent liability by virtue of being a control group member with a plan sponsor if the control group member is a contributing sponsor of the plan to which the plan liabilities are transferred?

(e) Is the exclusion of "securities and other debt instruments" from the term "amounts collected" in Section 4064A(d)(1), as amended by the bill, intended to cover marketable securities and debt instruments?

(f) Section 406A(d)(2) refers to a change occurring with respect to "unfunded guaranteed benefits." Section 406A(e)(1) refers to "unfunded vested benefits with respect to which the change occurred." Is there any significance in this difference in terminology?

(g) Section 4064A(d)(4) refers to Sections 4041(g)(1)(B)(ii) and (iii). We have been unable to find these referenced sections.

(h) In example 1 in the summary of the bill, should the reference to $3 million be a reference to $4 million ($9 million of guaranteed benefits as of the date of the transfer, less $5 million, the value of the assets as of that date)?

We appreciate this opportunity to submit our views upon this important matter. While we continue to hope that the single-employer plan

insurance program will be improved, we respectfully suggest that these improvements should not be attained at the cost of undue interference with normal business transactions and without regard to elementary principles of fairness. If these considerations are not properly taken into account, the only result we can foresee is that there will be fewer and fewer defined benefit plans. Should this occur, the PBGC may benefit, but the ultimate losers will be the employees and retirees whose interests the PBGC was originally established to protect.

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Respectfully submitted,

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Senator NICKLES. Again, thank you for your participation. The committee is adjourned.

[Whereupon, at 10:22 a.m., the subcommittee was adjourned.].

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